

EXHIBIT I

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

-----X

In re:

SECURITIES INVESTOR PROTECTION
CORPORATION,

Plaintiff-Applicant,

-vs-

BERNARD L. MADOFF INVESTMENT
SECURITIES, LLC,

Defendant.

-----X

In re:

BERNARD L. MADOFF,

Debtor.

-----X

*** CONFIDENTIAL ***

VIDEOTAPED DEPOSITION

OF

BERNARD L. MADOFF
(Taken by the Customers)
Butner, North Carolina
December 20, 2016

Reported by: Lisa A. DeGroat, RPR
Notary Public

A P P E A R A N C E S

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Robert Collier

CONFIDENTIAL VIDEOTAPED DEPOSITION OF BERNARD L.
MADOFF, taken by the Customers, at the Federal
Correctional Institution, Butner Medium I, Old NC
Highway 75, Butner, North Carolina, on the 20th day of
December, 2016, at 8:52 a.m., before Lisa A. DeGroat,
Registered Professional Reporter and Notary Public.

C O N T E N T S

The Witness: Bernard L. Madoff	Examination
By Ms. Chaitman	6

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Madoff For Identification

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1 (MADOFF EXHIBIT 1 WAS MARKED FOR
2 IDENTIFICATION.)

3 * * * * *

4 THE VIDEOGRAPHER: We are now on the
5 record.

6 Please note that the microphones are
7 sensitive, and they pick up whispering and
8 private conversations. Please turn off all
9 cellphones or place them away from the
10 microphones, as they can interfere with the
11 deposition audio. The recording will continue
12 until all parties agree to go off the record.

13 My name is Bob Collier, representing
14 Veritext Legal Solutions. The date today is
15 December 20th, 2016, and the time is
16 approximately 8:52.

17 This deposition is being held at Butner
18 Federal Correction Facility, located at 3000 Old
19 75 Highway, Butner, North Carolina 27509 and is
20 being taken by counsel for the customers and
21 trustees.

22 The caption of this case is In re:
23 Securities Investor Protection Corporation,
24 Plaintiff-Applicant, v. Bernard L. Madoff
25 Investment Securities, L.L.C., Defendant.

1 And this case is being held in the
2 United States Bankruptcy Court, Southern District
3 of New York. Case number 08-01789 (SMB). The
4 name of the witness is Bernard L. Madoff.

5 At this time the attorneys present in
6 the room and everyone attending remotely will
7 identify themselves and the parties they
8 represent.

9 MS. CHAITMAN: Helen Davis Chaitman, of
10 Chaitman, L.L.P., on behalf of various defendants
11 in the good faith clawback actions.

12 MR. GOLDMAN: Peter A. Goldman. I
13 represent Bernard Madoff.

14 MR. SHEEHAN: David J. Sheehan, with
15 Baker Hostetler, attorneys for the trustee Irving
16 Picard.

17 MS. FEIN: Amanda Fein, Baker
18 Hostetler, for the trustee.

19 THE VIDEOGRAPHER: Our court reporter
20 is Lisa DeGroat, representing Veritext Legal
21 Solutions, and she will swear in the witness, and
22 we can proceed.

23
24 * * * * *
25

P R O C E E D I N G S

Whereupon,

BERNARD L. MADOFF,

having been duly sworn,

was examined and testified as follows:

DIRECT EXAMINATION BY COUNSEL FOR CUSTOMERS

BY MS. CHAITMAN:

Q. Good morning, Mr. Madoff. I want to hand you what I've marked as Madoff Exhibit 1, which is an order that was entered by Judge Bernstein permitting this deposition.

And there are specific topics that are defined in this as permitted topics of -- of questioning, and I'm going to limit my questions to those topics. This is Exhibit 1.

Just let me know when you've finished reading through seven -- the -- the permitted topics on this --

A. Oh.

Q. Page three. It's -- it's on page three.

A. Okay.

Q. Yeah.

A. Understood.

Q. Okay. Good. Thank you.

Mr. Madoff, it's been actually over eight

1 years since you confessed on December 11th, 2008. At
2 that point in time can you just briefly explain what
3 your emotional state was about confessing at that
4 moment?

5 A. Relieved, I guess you would say.

6 Q. Can you explain that?

7 A. Well, the -- you know, I had committed this
8 crime over a period of roughly 16 years, and the -- I
9 realized that, you know, certainly towards the end of
10 it that I could not go on any further.

11 And I was confronted by my brother and my
12 sons, because they realized that I -- I was not my
13 normal state, mental state, and that was when I
14 acknowledged, you know, my wrongdoing and the fact
15 that I was operating a -- a fraud or a Ponzi scheme.

16 And notified my wife at the same time, went
17 home that afternoon to discuss it with my wife and
18 admit this to my wife. And then my sons turned me in
19 to the U.S. attorney at the advice of their counsel,
20 which was Paul Weiss.

21 And I, you know, met with the -- a group of
22 attorneys and the trustee and -- and the SEC and the
23 U.S. attorney a couple of days after that, and, you
24 know, discussed what had happened.

25 And they asked me the same thing that you

1 just asked me, you know, about my mental state, and I
2 said that, you know, that I was relieved to -- to have
3 this thing over and get it off my chest. And they
4 all, you know, acknowledged, you know, that they must
5 have felt the same way.

6 Q. Now, were you represented by counsel at the
7 time that you met with the U.S. attorney and the
8 other --

9 A. Yes.

10 Q. -- people?

11 Okay. And who was your counsel?

12 A. Ira Sorkin.

13 Q. And --

14 A. From -- well, at that time he was with -- he
15 changed firms.

16 MR. GOLDMAN: Dickstein Shapiro.

17 THE WITNESS: Huh?

18 MR. GOLDMAN: Wasn't it Dickstein
19 Shapiro?

20 MR. GOLDMAN: Off the record.

21 THE VIDEOGRAPHER: Going off the
22 record. The time is 8:58.

23 (RECESS FROM 8:58 A.M. TO 8:59 A.M.)

24 THE VIDEOGRAPHER: Back on the record.
25 The time is 8:59.

1 BY MS. CHAITMAN:

2 Q. Let me start again with my question before
3 we were so rudely interrupted.

4 At -- at the time that you confessed to the
5 government officials were you represented by counsel?

6 A. Yes.

7 Q. And who was your counsel?

8 A. Ira Sorkin.

9 Q. How long had you known Ira Sorkin?

10 A. Oh, many, many years. Probably at least 20
11 years.

12 Q. And had he ever worked for the SEC?

13 A. I am not sure. No. He didn't work for the
14 SEC. He was -- he was a U.S. attorney, though.

15 Q. Okay. And is that the same Ira Sorkin who
16 represented Avellino & Bienes when --

17 A. Yes, it is.

18 Q. -- when the SEC --

19 A. Yes. He --

20 Q. -- investigated them in 19 --

21 A. In 1992.

22 Q. In 1992. Let me finish my question, and
23 then I'll let you finish your answer. Okay? I
24 promise.

25 Now, when -- I don't want you to disclose

1 any attorney/client privileged information between you
2 and Mr. Sorkin, but was Mr. Sorkin surprised when you
3 told him that you had been operating a Ponzi scheme?

4 A. Yes.

5 Q. In fact, had any family members of
6 Mr. Sorkin invested through you?

7 A. I believe his -- his -- his mother and
8 father had an account with me through Avellino &
9 Bienes.

10 Q. Okay. And -- so he represented Avellino &
11 Bienes with respect to the 1992 SEC investigation?

12 A. Yes. That's correct.

13 Q. And thereafter his parents invested with
14 you?

15 A. Well, I think they were a client prior to
16 that.

17 Q. Okay. And did they -- did they continue to
18 be clients after that?

19 A. Yes.

20 Q. They did?

21 A. I believe.

22 Q. Okay. So is it fair to say that if
23 Mr. Sorkin had come to learn that Avellino & Bienes
24 had done something illegal, that he would not have had
25 his parents continue to invest through you?

1 MR. SHEEHAN: Object to the form.

2 THE WITNESS: I -- you know, I don't
3 know -- well, the -- the issue with Avellino &
4 Bienes really had nothing to do with any
5 wrongdoing by me.

6 It was the fact that they were deemed
7 to be operating an unregistered investment
8 partnership, and the SEC, you know, acknowledged
9 to me that there was nothing wrong with what I
10 was doing.

11 And that if they were willing to
12 register, I could continue register --
13 registering -- continue investing for them. I
14 refused to at that time and insisted upon
15 returning their moneys and closing out their
16 account.

17 So, as far as the SEC, or as far as any
18 of Avellino & Bienes' clients are concerned,
19 based upon everything that happened, none of them
20 would have any reason to feel that I was doing
21 anything wrong. It was Avellino & Bienes that
22 had the problem.

23 BY MS. CHAITMAN:

24 Q. Now, you recall that you appeared before
25 Judge Chin and entered a guilty plea in June of 2009?

1 A. Yes.

2 MS. CHAITMAN: Okay. And I'm going to
3 mark the transcript of that proceeding as
4 Exhibit 2.

5 (MADOFF EXHIBIT 2 WAS MARKED FOR
6 IDENTIFICATION.)

7 BY MS. CHAITMAN:

8 Q. Mr. Madoff, do you have a good recollection
9 of that day?

10 A. Yes.

11 Q. Okay. If you'd be good enough to turn to
12 page 25.

13 A. Okay.

14 Q. Now, just to put this into context, you
15 confessed on December 11th, 2008, and Mr. Sorkin began
16 representing you at that time; right?

17 A. Yes.

18 Q. And you entered a guilty plea -- actually,
19 it was March 12th, 2009. Do you see that, that's the
20 date --

21 A. Uh-huh.

22 Q. -- on the first page?

23 A. Yeah.

24 Q. Okay. And during the period, from
25 December 11th until March 12th, you had been living in

1 your apartment; is that right?

2 A. Yes.

3 Q. And is it fair to say that you had a lot of
4 time to think about what you had done?

5 A. Yes.

6 Q. When you spoke to Judge Chin on March 12th,
7 2009, did you tell the truth about what you had done?

8 A. Yes.

9 Q. I want to read, beginning on line 12 of page
10 25, the -- the one paragraph. Quote, "To the best of
11 my recollection, my fraud began in the early 1990s.
12 At that time the country was in a recession, and this
13 posed a problem for investments in the securities
14 markets."

15 "Nevertheless, I had received investment
16 commitments from certain institutional clients and
17 understood that those clients, like all professional
18 investors, expected to see their investments
19 outperform the market."

20 "While I never promised a specific rate of
21 return to my client, I felt compelled to satisfy my
22 clients' expectations at any cost. I, therefore,
23 claimed that I employed an investment strategy I had
24 developed called the split-strike conversion strategy
25 to falsely give the appearance to clients that I had

1 achieved the results I believed they expected."

2 Is that statement 100 percent true?

3 A. Yes. However, there's -- if I understand
4 this statement, it said that -- that -- "to falsely
5 give the appearance," implies that I had achieved the
6 results. When I took the money and I started the
7 strategy, the strategy -- there was nothing in the
8 strategy to give a false impression.

9 In other words, I was the -- you know, I
10 intended to invest the money. The fact that I
11 invested -- that I couldn't invest it because of
12 market conditions, but then shorted the strategy to
13 the clients, then it was -- it -- it gave the false
14 impression, but that -- it was not my intention when I
15 first developed the strategy or made the commitments
16 to the clients to -- to not invest the money at that
17 time.

18 Q. Okay. So, if I understand you correctly,
19 when you developed the split-strike conversion
20 strategy, your intention was to carry it out --

21 A. Correct.

22 Q. -- honestly?

23 A. Correct.

24 Q. But you didn't have the money to do that,
25 and so you --

1 A. I didn't have the market conditions to do
2 that.

3 Q. Okay. So you started sending statements to
4 clients which were not accurate, because they
5 reflected purchases of securities that did not occur?

6 A. Yes. That's correct.

7 Q. Okay. Now, you understood that this was a
8 fraud on your customers; right?

9 A. Yes.

10 Q. And is it your testimony that you never
11 perpetrated a fraud on your customers prior to the
12 initiation of the split-strike conversion strategy?

13 A. That's correct.

14 MR. SHEEHAN: Object -- object to the
15 form.

16 THE WITNESS: I'm sorry. I didn't hear
17 what you just --

18 MR. SHEEHAN: I said I objected to the
19 form.

20 THE WITNESS: Oh.

21 MR. SHEEHAN: We have an understanding
22 that all objections are preserved, as subject to
23 objections as to form.

24 MS. CHAITMAN: Right, but what is your
25 objection to that form? I just want to --

1 MR. SHEEHAN: You're testifying.

2 MS. CHAITMAN: Okay. Okay.

3 MR. SHEEHAN: All right.

4 BY MS. CHAITMAN:

5 Q. Mr. Madoff, can you tell us in your own
6 words whether you had ever -- prior to the
7 split-strike conversion strategy ever misrepresented a
8 purchase or a sale on a customer's statement so that
9 the customer was misled?

10 A. Yes.

11 Q. When?

12 A. Well, basically after the market crashed in
13 1987, certain customers that were not doing the
14 split-strike conversion strategy, but were involved in
15 a -- in a normal market-hedging strategy, where there
16 were commitments on both my side and the client's side
17 to keep the strategy open, and -- because of the
18 market crash they were forcing me to liquidate part of
19 their -- their strategy in violation of a commitment
20 that -- that they had made to me and to others.

21 That was done, and that triggered in the
22 years after that, which I guess started primarily --
23 that went really from the early '90s on through, you
24 know, 2008, where those clients gave instructions to
25 do some backdating of transactions, and, you know,

1 liquidating of securities or -- and so on to generate
2 certain losses that they deemed desirable for tax
3 purposes.

4 So I was aware of the fact that those --
5 and, you know -- and told the clients that they were,
6 you know, basically, you know, running into a tax
7 violation problem. So that had nothing to do with the
8 split-strike conversion, and that was --

9 I don't know if I've answered your question.

10 Q. Okay. Well, we've gone into a different
11 subject, but let me, if I may, just come back to my
12 question, and perhaps I misstated it.

13 What I was really asking you -- I'm not
14 asking you whether a client directed you to do
15 something illegal.

16 A. Right.

17 Q. Because that would not be a fraud on that
18 client; right?

19 A. No.

20 Q. Yeah.

21 A. That's correct.

22 Q. Okay. So I want you to limit --

23 A. It was a violation for probably the SEC
24 regulations on my part, but it was not a fraud. It
25 was -- it was the clients that, you know, instructed

1 what should be done to employees in my firm.

2 Q. Okay.

3 A. My employees in my firm.

4 Q. Okay. We'll come back to that, but I want
5 you to focus now solely on the situation where you are
6 making a misrepresentation to a client and the client
7 doesn't know the truth.

8 A. Okay.

9 Q. Prior to the split-strike conversion
10 strategy did you ever orally or in writing make a
11 misrepresentation to the client where the client
12 didn't know the truth?

13 A. No.

14 Q. Are you absolutely sure about that?

15 A. Yes.

16 Q. Now, to the best of your recollection do you
17 remember when in 1992 you started to do the
18 split-strike conversion strategy?

19 MR. SHEEHAN: Object to the form.

20 THE WITNESS: No. I would just say it
21 was the early part of '92.

22 BY MS. CHAITMAN:

23 Q. Okay. But we can look at statements, and we
24 would be --

25 A. Yeah.

1 Q. -- able to recognize that --

2 A. Yes.

3 Q. -- that -- a statement would show that
4 trading strategy; isn't that true?

5 A. Correct.

6 Q. Okay.

7 A. It should.

8 Q. Okay. So is it your testimony that if we
9 found the first split-strike conversion statement,
10 that you would say that that's when the fraud began?

11 A. When I failed -- well, it's -- I had
12 developed a strategy before '92, the split-strike
13 strategy before '92. And I might have actually done
14 some transactions, but I was -- it wasn't until
15 sometime after '92, when the market conditions
16 changed, that I was not able to continue doing the
17 split-strike, and that's when the fraud began.

18 Q. So how would we determine -- what market
19 conditions should we look for in order to determine
20 when you actually stopped buying the positions that
21 were reflected on the statements?

22 A. Well, you could look for the -- you can look
23 for the transactions and -- well, you would -- you
24 could look at the market conditions that occurred, you
25 know, in '92.

1 It was actually -- this started during the
2 Gulf War situation. I don't remember the exact dates
3 of when I -- when I started or stopped it, but
4 there -- '92 is a ballpark number.

5 Q. What were the specific market conditions
6 that led to your not actually purchasing the
7 securities that were reflected on the statements?

8 A. There wasn't enough volatility or really
9 volume to do what I wanted to do for the strategy.

10 Q. Explain to me what you mean by that. You
11 mean there weren't enough shares of the securities
12 that you were --

13 A. It was a combination of not -- the strategy
14 was basically a strategy that required sort of an
15 upmarket, a market that would appreciate. So at that
16 time the markets were in a very fragile state, because
17 of the -- the Gulf War, and there was -- the recession
18 had already started.

19 So in order for the strategy to work
20 successfully you basically had to have an upward bias
21 in the market for the -- for the basket of securities
22 that were involved in the strategy to move towards the
23 upward strike price of the call options that you sold
24 for the strategy.

25 MS. CHAITMAN: Okay. Okay. Now I'd

1 like to mark as Exhibit 3 the transcript of the
2 plea of Mr. DiPascali.

3 (MADOFF EXHIBIT 3 WAS MARKED FOR
4 IDENTIFICATION.)

5 BY MS. CHAITMAN:

6 Q. Now, Mr. Madoff, I'd like you to -- if you'd
7 look at the transcript, the first page, you can see
8 this is an August 11th, 2009 transcript before Judge
9 Sullivan in the United States of America versus Frank
10 DiPascali. Do you remember when he plead guilty?

11 A. Yes.

12 Q. Okay. If you'd be good enough to turn to
13 page 44.

14 A. Uh-huh.

15 Q. The -- the court is asking Mr. DiPascali
16 to -- to read his plea, and the court says, and I
17 quote, "Let me ask you to read slowly, so that the
18 court reporter can get it down."

19 And then the defendant says, Mr. DiPascali
20 says, and I quote, "I am standing here today to say
21 that from the early 1990s until December of 2008" --

22 MR. SHEEHAN: Where are you?

23 THE WITNESS: Excuse me.

24 MS. CHAITMAN: Page 44.

25 THE WITNESS: Page 44.

1 MR. SHEEHAN: I think we may have the
2 wrong copy.

3 MS. CHAITMAN: You have the wrong --

4 THE WITNESS: Right.

5 MR. SHEEHAN: This is Kugel.

6 MR. GOLDMAN: Right.

7 MS. CHAITMAN: Oh, this is Kugel. Oh,
8 I'm sorry.

9 THE VIDEOGRAPHER: Your mike. Your
10 mike.

11 MS. CHAITMAN: Okay. Sorry.

12 THE WITNESS: David, could you do me a
13 favor and just get me a soda or something to
14 drink?

15 MR. GOLDMAN: Do you want a Pepsi?

16 THE WITNESS: Yeah, anything is fine.
17 I'm losing my voice.

18 MR. GOLDMAN: Could I just ask for a
19 clarification. I know we're not using the
20 exhibit right now, but the Bates stamp, "Public,"
21 at the bottom, does that mean that's open?

22 MR. SHEEHAN: Correct.

23 MR. GOLDMAN: Is it under the
24 confidentiality order? I just want to make sure
25 I'm clear on what the confidentiality --

1 MR. SHEEHAN: No. That's a public
2 document.

3 MR. GOLDMAN: Okay. Okay. Fine. You
4 can continue while I get his soda.

5 MR. SHEEHAN: Sure.

6 MS. CHAITMAN: Okay. Are we back on
7 the record?

8 Okay. I'm going to mark as Exhibit 4
9 what I had intended to mark as Exhibit 3, which
10 is the DiPascali plea.

11 THE WITNESS: Do you want page 44
12 again?

13 MS. CHAITMAN: Yes.

14 (MADOFF EXHIBIT 4 WAS MARKED FOR
15 IDENTIFICATION.)

16 MS. CHAITMAN: And if you'd go to page
17 44. Everybody, just make sure that you've got
18 the right document.

19 THE WITNESS: Okay.

20 MS. CHAITMAN: Everybody is okay?

21 MR. SHEEHAN: Yup.

22 BY MS. CHAITMAN:

23 Q. Good. Okay. So I'm going to read when the
24 judge tells DiPascali he can begin. It's on line 18
25 of page 44.

1 "I am standing here today to say that from
2 the early 1990s until December of 2008 I helped Bernie
3 Madoff and other people carry out the fraud that hurt
4 thousands of people."

5 "I am guilty, and I want to explain a little
6 bit about what I did and how I want everybody to know
7 that I take responsibility for my conduct."

8 And then if you'd skip to page 46, line
9 nine. And I quote, "From at least the early 1990s
10 through December of 2008 there was one simple fact
11 that Bernie Madoff knew, that I knew and that other
12 people knew, but that we never told the clients, nor
13 did we tell the regulators, like the SEC. No
14 purchases of" -- "or" -- I think it should have
15 been -- "or sales of securities were actually taking
16 place in their accounts. It was all fake. It was all
17 fictitious. It was wrong, and I knew it was wrong at
18 the time."

19 And then the court said, "When did you
20 realize that?"

21 And DiPascali said, "In the late '80s or
22 early '90s."

23 And then if you look on page 47.

24 A. Uh-huh.

25 Q. Page -- line five. The -- Mr. DiPascali

1 said, "Most of the time the clients' money just simply
2 went into a bank account in New York that Bernie
3 Madoff controlled. Between the early '90s and
4 December 2008, at Bernie Madoff's direction, and
5 together with others, I did the following things."

6 "On a regular basis I told clients over the
7 phones and using wires that transactions on national
8 securities exchanges were taking place in their
9 account when I knew that no such transactions were
10 indeed taking place."

11 "I also took steps to conceal from clients,
12 from the SEC and from auditors the fact that no actual
13 security trades were taking place and to perpetuate
14 the illusion that they actually were."

15 Now, Mr. DiPascali in one place -- in two
16 places he said it was the early '90s, and in one place
17 he said it was the late '80s or early '90s.

18 When to the best of your recollection did
19 Mr. DiPascali become involved in dealing with
20 investment advisory customers?

21 A. Well, he -- he knew that I was doing
22 customer business, you know, you know, in the '80s.
23 Primarily the -- what I was just talking about with
24 some large clients and also the convertible arbitrage
25 clients, he was aware -- he was aware of that

1 business.

2 He was also aware that what happened in '87
3 and -- and during the crash that, you know, there was
4 some -- there was some -- there was some clients that
5 were wanting to sell out of their positions that they
6 had had because of their concern about the market.

7 And that I had, you know, objected to that,
8 telling them that this was in violation of their
9 commitments that they had made originally. So he was
10 aware of the fact that those discussions were taking
11 place.

12 And he was also aware of the fact that I was
13 doing -- actually doing the convertible arbitrage
14 transactions prior to that.

15 Q. Okay. But in terms of the -- the crime that
16 he's admitting to here --

17 A. Right.

18 Q. -- can you shed any light on whether, in
19 fact, this began in the late '80s or the early '90s?

20 A. Oh, it -- it began, as I said, in the '90s.

21 Q. Okay. All right. And when you say in the
22 '90s, are you fairly certain it was 1992?

23 A. That was -- yes. That was the date -- the
24 approximate date that I said it started, because
25 that's when I really started to take in the money to

1 do the split-strike trades.

2 Q. Okay. All right. Now I'd like to go to --

3 MS. CHAITMAN: You-all have
4 Mr. DiPascali's transcript?

5 MR. SHEEHAN: Mr. Kugel's.

6 MS. CHAITMAN: I'm sorry. Mr. Kugel's
7 transcript?

8 MR. SHEEHAN: Yup.

9 THE WITNESS: Uh-huh.

10 MS. CHAITMAN: Okay. Can I just have
11 Kugel's transcript for a second?

12 BY MS. CHAITMAN:

13 Q. All right. So I've marked this as
14 Exhibit 3. Now, if you'd be good enough to look at
15 page 32. I'm going to read, beginning on line four.
16 This is Mr. Kugel's plea, and he gave this plea on
17 November 21st, 2011.

18 "Specifically beginning" -- it should be --
19 "in the early '70s until the collapse of BLMIS in
20 December of 2008 I helped create fake backdated
21 trades."

22 "I provided historical trade information --
23 sorry -- first to Annette Bongiorno and later to Joann
24 Crupi and others, which enabled them to create fake
25 trades that when included on the account statements

1 and trade confirmations of investment advisory clients
2 gave the appearance of profitable trading, when, in
3 fact, no trading had actually occurred."

4 "I helped Bongiorno, Crupi and others create
5 these fake backdated trades based on historical stock
6 prices and were executed only on paper."

7 Now, during the 1970s and '80s who within
8 the firm was responsible to deal with the clients that
9 you've described were involved in transactions that
10 you felt were violations of either the tax laws or the
11 securities laws?

12 A. Well, first of all, I was the only one that
13 dealt with the clients, period, as far as doing the
14 trading.

15 Q. Okay.

16 A. So none of this makes sense to me, because I
17 think David Kugel started in the '70s working for me.

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9 Q. Okay.

10 A. And there were some others, but primarily
11 those.

12 Q. Okay. And --

13 A. Those are my four big clients.

14 Q. And did each of the four big clients have
15 multiple accounts?

16 A. Yes.

17 Q. So they might have had accounts for their
18 children or their --

19 A. Yes. They all did.

20 Q. Okay. So can I refer to them as the four
21 families?

22 A. Yes.

23 Q. Okay. When did you begin doing business
24 with the four families? Was it at different times?

25 A. Varied times. Yeah. It started from the

1 early '60s, you know, through 2008.

2 Q. Okay. Let me just take them one by one.

3 Carl Shapiro?

4 A. Yes. He was probably the first one.

5 Q. And would that date back to the 1960s?

6 A. Yes.

7 Q. Norman Levy?

8 A. Probably started in the '70s.

9 Q. Okay. Stanley Chais?

10 A. In -- in the '60s and '70s.

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14 Q. Okay. And who among your employees dealt
15 with the four families?

16 A. Well, I dealt with the families as -- you
17 know, initially with them, but when it came to doing
18 bookkeeping work, backdating their trades or changing
19 statements, which I looked at as an SEC violation,
20 that they were -- they were dealing directly with
21 primarily Annette Bongiorno, who was the bookkeeper at
22 that time.

23 Jodi Crupi came on -- I'm not sure. It was
24 a little bit later, but she was not really involved in
25 the -- handling the four clients, certainly with their

1 account statements and so on. That was primarily
2 Annette -- Annette Bongiorno's responsibility.

3 Q. Okay. So, just to be clear, Annette
4 Bongiorno would have direct contact with the four
5 families?

6 A. With -- yes.

7 Q. And when we say, "the four families," are
8 you saying that Norman Levy himself would call Annette
9 directly or would he have someone in his office?

10 A. Norman Levy or his accountant, which at that
11 time was Adam Woltz, who is no longer alive.

12 Q. Okay. And with respect to Picower, would it
13 be Picower directly or --

14 A. Primarily it was Picower directly and his
15 assistant, which was -- who was April Freilich.

16 Q. Okay. And with respect to Stanley Chais?

17 A. It was primarily Stanley Chais himself.

18 Q. And with respect to Carl Shapiro?

19 A. It was Carl Shapiro or it was his
20 accountant, who was with Coopers & Lybrand.

21 Q. Okay. And, just to be very clear about
22 this, because Mr. Kugel is suggesting something quite
23 different, I just want to be very clear, is it your
24 testimony that these transactions for the four
25 families were done specifically at their direction?

1 A. Yes. David Kugel had nothing to do with
2 these clients. I don't think he's ever spoke to them
3 at this stage. What did he say?

4 Q. Okay. Okay.

5 A. David Kugel's work for me was strictly
6 involving arbitrage securities, convertible bond
7 arbitrage securities. It had nothing to do with --
8 with the trades, the hedged trades that they were
9 doing to get long-term gains.

10 In other words, there's -- David Kugel was
11 hired as an arbitrageur in convertible securities, and
12 that's all he ever was involved in. He was not
13 involved in -- and he would have no reason to give
14 Annette Bongiorno or anybody else in my firm any
15 instructions to create any trades, because they were
16 not -- because he didn't -- he only dealt in
17 convertible securities.

18 And these people were -- were primarily
19 dealing with, you know, just long positions. They did
20 have convertible arbitrage accounts, like everybody
21 else did in the very early stages, but most of their
22 money was involved in these long position accounts, as
23 we called them, which was handled by -- by me and by
24 Annette Bongiorno. And David Kugel, to my knowledge,
25 never touched anything with those trades.

1 Q. Now, with respect to the convertible
2 arbitrage trading that you did for the investment
3 advisory customers from -- from the 1980s, was that
4 all actual trading that was conducted?

5 A. Correct.

6 MR. SHEEHAN: Object to the form.

7 Sorry.

8 BY MS. CHAITMAN:

9 Q. Sitting here today, Mr. Madoff, are you
10 absolutely certain that the convertible arbitrage
11 trading, which was done for your investment advisory
12 customers, was executed trading which was actually
13 performed by your office?

14 A. Correct.

15 Q. Okay. Is there any doubt in your mind about
16 that?

17 A. No.

18 Q. Now, did David Kugel report to you with
19 respect to his trading?

20 A. Yes.

21 Q. And was his compensation determined based
22 upon his trading performance?

23 A. Correct. All my traders were compensated
24 that way.

25 Q. So tell me how that worked. Did he have to

1 on a periodic basis supply to you reports of his
2 trades?

3 A. He -- well, he -- you know, he doesn't -- he
4 doesn't have -- the way the -- the way the firm was
5 always operated, which was typical of all firms like
6 ours, market-making or dealer firms, each
7 market-maker, which David Kugel was one of them, that
8 made market in convertible securities, which was
9 really basically all he did.

10 They -- their compensation is based upon a
11 percentage of their net trading profits. So I,
12 particularly at that time, when the firm was much
13 smaller, was very familiar with what the firm's
14 trading profits were with each trader.

15 And David Kugel was one of a number of
16 convertible bond traders in my firm. You know, I
17 always monitored what their -- what their long and
18 shorts were, what their profits were and all.

19 And, of course, it was then -- each trader
20 had his -- had his own account that was kept by the
21 bookkeepers in the firm, and that -- and that was
22 Annette Bongiorno -- not Annette Bongiorno. She had
23 nothing to do with that.

24 That was, you know, handled by the
25 operations people in the firm. And they got a report.

1 We had a report at the end of each month, which was
2 monitored on a, you know, daily basis as to what their
3 profits were.

4 Q. So let me just understand this. Was there a
5 system in place where you had the ability to monitor
6 on a daily basis what David Kugel --

7 A. Yes.

8 Q. What trades he did?

9 A. Yeah.

10 Q. And how often would you monitor that?

11 A. Pretty much daily.

12 Q. So you would come into the office and
13 monitor on a daily basis what each of the traders had
14 done the day before?

15 A. At the time he's talking about, yes.

16 Q. Okay. And when you say, "at the time he's
17 talking about," you mean the '70s and the '80s?

18 A. Well, in -- certainly in the '70s. You
19 know, in the '80s my sons came into the firm, and
20 the -- the SEC has very specific regulations when it
21 comes to market-making firms.

22 And it's -- the regulation requires there to
23 be a Chinese wall established with the firm, where
24 each trader is only privy to his own trading profits
25 or losses and his positions or risks.

1 And there has to be a -- we had two
2 different types of operations. We had proprietary
3 trading, which is trading for the firm's own account,
4 and market-making, which is also for the firm's own
5 account, but involve making a two-sided market in --
6 in securities, particularly convertible securities,
7 which was our specialty at that time.

8 So the -- the trader -- each trader only
9 knows what he is buying and selling. He has no idea
10 what the firm is buying and selling. He has no idea
11 what the firm's -- what those positions are. They're
12 walled off.

13 You even have to have a separate supervisor
14 for each one of those departments. So, for example,
15 in the later years my son -- one son ran the
16 market-making department, supervised that. One
17 firm -- one son managed the proprietary trading side
18 of the firm.

19 And then the -- the only one that was
20 familiar with the overall positions of the firm and
21 the firm's investment account was myself, because I
22 was the only one that handled that.

23 So David Kugel would only be privy, like --
24 like any other trader, to what he was buying and
25 selling, what his profit and loss was, not -- not the

1 rest of the firm.

2 Q. Okay. And if he did trades that were
3 fictitious, is -- was there some -- if he -- if he
4 gave you a false report as to what he had traded,
5 would you have been able to pick that up?

6 A. Sure.

7 Q. How?

8 A. Well, because I was -- it's between those --
9 in the '70s is what he's talking about. You know,
10 I -- I -- the firm was not that large that I wouldn't
11 know -- I knew what was going on everywhere in the
12 firm.

13 So I knew -- I would know whether or not he
14 had -- what he was buying and selling. You know, I
15 could see that the firm had -- you know, had the
16 ability, you know -- we had to supervise -- I had to
17 supervise what the firm's risk was, what their
18 positions were, what their inventory was.

19 So if he was creating trades, as he -- as
20 this states, certainly I would know that the trades
21 didn't -- you know, were fictitious.

22 Q. How could you tell -- if he gave you a
23 report, which said, I earned X dollars last month,
24 because I did all of these trades, if he put down
25 fictitious trades, how could you check to make sure

1 they were real?

2 A. Because there were trades -- well, any
3 number of ways. Number one, if he created -- if a
4 trader creates a ticket that is wrong, that says he
5 bought stock and sold stock and didn't, then when the
6 delivery -- when the securities were not delivered or
7 not came in, they wouldn't settle.

8 So there would be -- it would be a vacuum
9 between -- you know, because the way the stock market
10 works, when you do a trade, eventually the trades get
11 settled and the delivery is made of the securities and
12 people pay for it.

13 To say nothing of the fact that we monitor
14 what is being bought and sold for the firm on an
15 ongoing basis. So -- so we would know what the
16 exposure of the firm was, what the profitability of
17 the firm was.

18 So a trader -- a trader can't, you know,
19 create a -- now -- nowadays, you know, with large
20 volumes and so on if you have a lot of traders, a
21 trader can put through what they call a wooden ticket
22 or a rogue trade. That's what you hear about.

23 You can do that if the firm is very large.
24 You know, unless the firm has the proper automation,
25 which we certainly had in the later days, you know,

1 you would -- you would be able to detect that.

2 Q. Okay.

3 MR. GOLDMAN: Bernie, if you get tired
4 or you want to stand up and stretch at anytime,
5 just tell us. Okay?

6 THE WITNESS: I'm okay.

7 Can -- can I interject something that I
8 think that maybe will -- will clear up this thing
9 with David Kugel?

10 MS. CHAITMAN: Sure.

11 THE WITNESS: And this -- because
12 this -- this -- this issue of him creating
13 fictitious trades surfaced originally when you
14 were down here last time, seven years ago or six
15 years ago or whatever it was.

16 BY MS. CHAITMAN:

17 Q. Okay. When you -- when you said, "you,"
18 you -- you looked at Mr. Sheehan?

19 A. David Sheehan.

20 Q. Okay.

21 A. Yes. Where a -- a scrap of paper was handed
22 to me and to my attorney, Ike Sorkin, at that time
23 that had a handwritten scribbling of a formula with a
24 convertible bond on it that said, for example, X
25 convertible bonds equals X number of shares of stock.

1 It was a -- it was a -- it was when we were
2 setting up a -- the way we traded convertible bonds,
3 which is typical of any -- any firm like ours, for a
4 client. You know, you buy stock into a trading
5 account, because we deal always as principal.

6 So the stock -- we go out, and we buy --
7 we -- as a market-maker we maintain positions in -- in
8 convertible bonds and also in, you know, the related
9 security for that.

10 And then those securities, if they're
11 allocated to clients after the -- the positions are
12 accumulated, you then break up -- you break up the
13 trade. That may be 100 bonds, and you're going to
14 give each client, for example, ten bonds or 15 bonds
15 and so on.

16 So an instruction sheet is issued to --
17 basically to the operations side of the firm as to,
18 you know, how you allocate a buy and a sell.

19 All right. So David Kugel, as one of my
20 convertible bond traders. All right. If the firm was
21 selling -- if -- whether it be from my investment
22 account or from another trader's account, if we were
23 going to -- if I wanted to sell a convertible bond to
24 a client from my firm's trading account or investment
25 account, then, you know, the instructions had to be

1 issued to the back office as to how many shares or
2 bonds to -- to transact for a client.

3 So this scrap of paper was an instruction
4 sheet that David Kugel, if he was one of the
5 market-makers in a particular security, would be told
6 okay by me, all right. I want to give this bond to
7 this client and so on.

8 He would write an instruction sheet out to
9 the back office, to Annette Bongiorno or Jodi Crupi,
10 if she was there at the time, that this -- this is how
11 you convert this bond.

12 In other words, this bond -- because the
13 back office are not familiar, not being traders, with
14 what the -- what the formulas are. So at the -- that
15 is probably one of maybe 100 different scraps of paper
16 that -- that would be issued or written by David Kugel
17 or another trader, if there was another trader
18 involved, you know, of what the allocation formula is.

19 Now, at that time, you know, when -- the
20 first meeting that I had with the attorneys down here
21 and my attorney, they showed me this piece of paper.
22 And they asked me, what is this?

23 And I looked at it. And at first I wasn't
24 really sure what it was, because the handwriting was
25 hard for me, you know, to understand. Then I said

1 to -- it looks like to me like a formula, and it looks
2 like David Kugel's handwriting.

3 So I -- I explained, just as I explained to
4 you now, what this was. And I said, you'd probably
5 find a lot of them. So they said, well, you know, so
6 he's the one that is -- that is writing this? And I
7 said, yes. It's an instruction sheet.

8 This is not uncommon for -- you know, this
9 is the way the business is done. That -- now, this
10 was not a fictitious trade. It was -- it was just
11 instructing the -- the operations side of the firm
12 what the allocation.

13 It would be no different than if I said, I'm
14 selling to Carl Shapiro, you know, 1,000 shares of IBM
15 that we had bought, you know, as a -- you know, as
16 part of our business. I would -- I would put through
17 an -- an instruction sheet, sell 1,000 shares of IBM
18 to Carl Shapiro.

19 In David Kugel's side, if he was a trader in
20 that particular security, he would issue the same
21 instruction for that. These are not -- there's
22 nothing fictitious about it.

23 So that -- none of that makes any sense to
24 me. And I think that -- that, you know, one of the
25 problems that I had when I, you know, met with both

1 the proffer agreement and so on, when I gave my -- and
2 told how the firm operated, there seemed to be sort of
3 a blank stare in the room when I said certain things.

4 And for an example -- now, in fairness to
5 the people that were there, whether it be the trustee,
6 whether it be the U.S. attorney or all the other
7 people and the attorneys and all, the market-making
8 business, the dealer business is -- is a specialized
9 type of business.

10 It is not Merrill Lynch. You know, if you
11 ask the average person how the stock markets work and
12 how Merrill Lynch works, they have no clue. You know,
13 they actually think that every time you buy, for
14 example, a share of stock, the money goes to the
15 company, and the company, you know, invests it.

16 When the average person buys a share of
17 stock, the company gets nothing. It's just all he's
18 doing is buying and selling, you know, from other
19 clients that have the stocks, but people never
20 understood that.

21 The market-making and dealers are a very
22 specialized type of business, and they really don't
23 have a clue. And the best example that I can use is
24 that the U.S. -- the -- the prosecutor at the time
25 asked me, can you please explain the history of the

1 firm and how you operated?

2 And I said, well, when? He says, from the
3 beginning. So I started in 1960, which is when I
4 started the firm, and I went into -- then after I got
5 to a certain period, I said, like in the '70s I became
6 a market-maker, and I, you know, bought stock, and I
7 sold stock for clients, as well as the firm.

8 Sometimes I was long stock. Sometimes I
9 shorted stock. And I said the word short, and it was
10 like there was a magic, you know, word that I said.
11 He said, short? And what does short mean?

12 And I'm sitting there in a room that has at
13 least three or four SEC people sitting there. So I
14 said, you don't know what short is? And everybody --
15 nobody said anything.

16 So I had to explain the shorts. He said, so
17 you're selling stock, and you don't own it? You
18 shorted it? I said, yes. As a market-maker I'm
19 required at times to sell a stock short.

20 It's part of my -- my job. I have to -- I
21 am required to make a two-sided market. Meaning I
22 have to make a bid and make an offer as a registered
23 market-maker.

24 So, yes, I do short stock for customers. I
25 sell them stock they don't own. Hopefully I'm going

1 to buy it back, you know, at a profit, not a loss, but
2 that is the typical way of doing business.

3 So, to get back to the -- this issue of
4 David Kugel, when you talk about, you know, him
5 putting instructions to the operations side of the
6 firm, how to allocate a position or a formula, there's
7 nothing unusual about that.

8 It's an everyday occurrence in a
9 market-making firm. How or why he would say that he
10 was creating a fictitious trade, I'm sort of
11 dumbfounded. You know, I just -- it doesn't make any
12 sense to me. And the timing is -- is -- doesn't make
13 any sense to me, you know.

14 Q. Okay. Now, you've just said that you
15 started your business in 1960. Can you tell us the
16 various distinctions that you achieved in the
17 securities industry?

18 A. What do you mean distinctions?

19 Q. Well, you were president of the NASDAQ.

20 A. Oh, you mean the -- my --

21 Q. Achievements.

22 A. All right.

23 Q. You're reading from notes.

24 A. I'm reading from -- because, you know, my
25 brain is a little bit --

1 MR. SHEEHAN: Could -- could we mark
2 that note?

3 THE WITNESS: -- is fried.

4 MR. SHEEHAN: It should be part of the
5 record, if he's going to read from it.

6 MS. CHAITMAN: Yeah, yeah.

7 MR. SHEEHAN: But you read from it
8 first. We'll mark it afterwards.

9 THE WITNESS: Okay. Well, okay. I was
10 chairman of --

11 BY MS. CHAITMAN:

12 Q. Are these handwritten notes that you've --

13 A. Yes.

14 Q. -- prepared?

15 Okay. Okay.

16 A. The reason why I did this, by the way, is
17 I -- I understand that I have to establish my
18 credibility, you know, at this deposition, because I
19 was --

20 MR. GOLDMAN: Just read.

21 THE WITNESS: I was told that I had no
22 credibility, but apparently, from what I've read
23 in the, you know, cases that I've been reviewing,
24 people that are like David Kugel or Frank
25 DiPascali or other people in my firm, Annette

1 Bongiorno, who have been accused and admitted
2 guilt, they seem to be the witnesses that all of
3 a sudden have credibility.

4 So -- but I have no credibility, and I
5 don't understand how -- I mean, I admitted that I
6 created a fraud, and for that I can understand
7 why there's some question about whether I have
8 credibility, but since everybody else is
9 establishing their credibility, I feel I have to
10 establish my credibility as well.

11 BY MS. CHAITMAN:

12 Q. Well, let me ask you something, Mr. Madoff.
13 You've been in prison about seven years?

14 A. Seven and a half years.

15 Q. Seven and a half years. And you've had a
16 lot of time to think, haven't you?

17 A. Unfortunately.

18 Q. Yeah. And you've been provided with the
19 services of a prison psychiatrist?

20 A. Yes.

21 Q. And is it fair to say that you allowed a
22 number of different people who are writers and
23 scholars to interview you?

24 A. Yes.

25 Q. Is it fair to say that you at this point

1 have had a very long time to think about what you did?

2 A. Uh-huh.

3 Q. You have to say yes or no.

4 A. Yes.

5 Q. Okay. And do you have any motivation at
6 this point to lie about what you did?

7 A. No.

8 Q. Okay. Tell us what accomplishments you had
9 achieved.

10 A. All right. I served as chairman of NASDAQ
11 and the NASD board of directors, chairman of the --

12 Q. Okay. And can you just explain for the
13 record what NASDAQ is?

14 A. NASDAQ is the automated marketplace for the
15 trading of non-listed securities and now listed
16 securities as well. It's an automated part of the
17 market, like the New York Stock Exchange.

18 Q. Okay.

19 A. So I --

20 Q. And when was NASDAQ formed?

21 A. NASDAQ was formed in the late '60s, early
22 '70s. I was one of the founders of NASDAQ. And then
23 became its chairman and served on the -- the board of
24 directors of NASDAQ for nine years.

25 I also served as chairman on the board of

1 the National Association of Securities Dealers, also
2 for nine years, starting in the early '80s through
3 that.

4 I was also founder and chairman of the
5 National Securities Clearing Corporation and
6 Depository Trust. I was chairman of the International
7 Securities Clearing Corporation.

8 I was chairman of the NASD trading
9 committee. Chairman of the NASD National Market
10 Design Committee. Chairman of the National
11 Association for Securities Business -- National
12 Business Conduct Committee, which is a regulatory arm
13 of the -- of the industry.

14 I served as chairman of an SEC Large Trader
15 Reporting Committee. I chaired -- was -- served as
16 chairman of the NASD Small Order Execution Committee.
17 Chairman of the NASD Surveillance Committee and
18 chairman of an SEC NASD Payment for Order Flow
19 Committee.

20 I was also a member of the Securities
21 Industry Association board of directors, the
22 Securities Industry Association Trading Committee,
23 Securities Industry Association Federal Regulation
24 Committee, Security -- chairman -- a member of the SEC
25 SIAV/SIA Capital Markets Committee.

1 I was chairman and member of the SEC
2 Intermarket Trading System Committee, which is the
3 committee that links all of the exchanges, the
4 New York Stock Exchange, NASDAQ and the five regional
5 exchanges. And I was head of the SEC NASD arbitration
6 committee. Those were the committees that I served on
7 over the history of my firm.

8 Q. Did you advise any foreign governments with
9 respect to the establishment of a stock exchange?

10 A. Yes. I was -- I served as the liaison and
11 consultant to the London Stock Exchange, the London
12 Futures Exchange, the Singapore Stock Exchange, the
13 Tokyo Stock Exchange, the Frankfurt Stock Exchange,
14 the Paris boards and the Moscow Stock Exchange.

15 MS. CHAITMAN: We have to wait a
16 second.

17 THE VIDEOGRAPHER: Going off the
18 record. The time is 9:56.

19 (RECESS FROM 9:56 A.M. TO 10:16 A.M.)

20 (MADOFF EXHIBIT 5 WAS MARKED FOR
21 IDENTIFICATION.)

22 THE VIDEOGRAPHER: Back on the record.
23 The time is 10:16.

24 BY MS. CHAITMAN:

25 Q. Mr. Madoff, we've taken a break, and do you

1 remember where we were when we were interrupted?

2 A. Yes. We were -- I had listed the number of
3 exchanges that I was advising on building new trading
4 platforms, and I listed, you know, basically London,
5 Singapore, Tokyo, Frankfort, Paris and Moscow.

6 This was basically partly at the request of
7 the SEC, who was asked by these various exchanges if,
8 in fact, they could have me willing to -- to travel
9 over there to consult with them on building a platform
10 that was similar to the NASDAQ platform that I was one
11 of the ones that designed that platform for -- for
12 NASDAQ.

13 And the SEC had a policy basically where
14 they would send up, you know, teams of employees to
15 come up -- basically compliance people, come up to
16 watch us into our trading room to witness us trading
17 on a daily basis and looking at the operations side of
18 the firm and the automation side of the firm.

19 So they would -- we did that for a number of
20 years, where they came and watched us trade, and we
21 consulted with them. So --

22 Q. Now, when you say, "they," you mean people
23 who were employed by the SEC --

24 A. Yeah. We had --

25 Q. -- would come to your offices?

1 A. The past four chairmen of the SEC have all
2 been up in my office, watching us trade and meeting
3 with us, as well as all of these foreign exchanges.

4 As a matter of fact, the -- the NASD used
5 our -- during the 9/11 crisis the SEC and the NASD
6 asked us, would we allow the NASD to -- to operate
7 their backer facility out of our backer facility that
8 we had in Queens, because that's the -- everybody was
9 having problems because of the -- you know, the -- the
10 bombing out of the -- the plane crashing into the
11 buildings.

12 So the NASD for a period of, I guess it was,
13 three months used our facilities to back up their
14 trades, and also their compliance people sat in my
15 office for a period of months, operating, you know,
16 because they didn't have -- their offices were
17 destroyed.

18 Q. Now, Mr. Madoff, I think you know that the
19 trustee has taken the position in court he has not
20 conceded that you ever did any legitimate trading.
21 Can you explain to us -- starting in 1960 and then
22 ending on December 11th, 2008 can you explain to us
23 the volume of trading that you did in various periods
24 of time and the number of employees whose job was to
25 conduct real trades?

1 A. Well, when I started my firm in 1960, it was
2 basically myself. And I operated at that time out of
3 my father-in-law's accounting office, because I was in
4 law school at the time. So in those days it was very
5 common for small brokerage firms to operate.

6 As a matter of fact, I started with \$500 of
7 capital. And that was a small amount even by the
8 SEC's standard during that time. So I was required to
9 meet with the New York office of the SEC to explain
10 how I basically had the nerve to present a handwritten
11 balance sheet with \$500 cash assets and no
12 liabilities.

13 And, you know, so they wanted to make sure
14 that I was real. And I started with the \$500 of -- of
15 capital, which in those days didn't require much,
16 because I was -- my plan was just to do a small retail
17 business basically with my family as clients.

18 That, you know, eventually grew from a
19 one-man operation to, I guess, you know, 200 some odd
20 people here and in -- in London in 2008.

21 I started this small retail firm.
22 Relatively unsuccessful the first couple of years,
23 because I ran into the Cuban missile crisis, and the
24 marketplace collapsed in 2000 -- in 1962.

25 Required me to borrow \$30,000 from my

1 father-in-law in the form of -- of municipal bonds to
2 recapitalize my firm, which I paid back, you know, a
3 year or so later.

4 And then gradually just -- and then became a
5 market-making firm in the '70s, early '70, and became
6 a market-making firm for the rest of the balance of my
7 50 years in the business.

8 At one -- we -- at the -- by the time we
9 were finished in 2008 the firm was operating -- was
10 executing a few 100,000 trades, up to 600,000 trades a
11 day at the high, but we were averaging about 300,000
12 transactions a day, and we represented ten percent of
13 the United States' volume in -- in transactions.

14 Q. Now, we're talking about legitimate
15 transactions?

16 A. All market-making were legitimate
17 transactions. The -- and the firm was operating
18 basically as -- primarily most of the time as a
19 market-making and proprietary trading firm.

20 It was -- the investment advisory firm
21 really came into -- you know, into being on a gradual
22 basis, and then was my undoing basically in the early
23 '90s, because of a problem that occurred originally in
24 '80 -- as I say, the crash in '87, but perpetuated a
25 fraud that started, as I said, in the '90s, which was,

1 you know, a disaster.

2 Q. And when -- the fraud in the '90s you're
3 referring to is the split-strike conversion?

4 A. Correct.

5 Q. Okay. Now, can you just briefly explain
6 what the difference is between market-making and
7 proprietary trading?

8 A. Well, market-making is -- in order to be a
9 market-maker, according to SEC and NASD regulations,
10 you have to maintain an inventory -- trading inventory
11 and making a two-sided market. In other words, you --
12 you post bids and offers to the -- to the market in
13 general.

14 Originally that was done in the
15 over-the-counter market through what was called pink
16 sheets, where they were daily published bids and
17 offers of the brokerage firms in the United States,
18 listing what you were willing to buy and sell
19 securities.

20 And you had to be ready to buy and sell
21 securities, whether either long or short, for -- for
22 the market in general or for your clients.

23 Then with the development of NASDAQ, which
24 was an -- which was the first automated system,
25 basically we automated the pink sheets.

1 So electronically you put your bids and
2 offers in a -- you know, on a screen-based system, and
3 that developed what -- I was one of the firms that --
4 that developed, came up with that concept.

5 And, as a matter of fact, my brother, Peter,
6 negotiated and wrote the first contract for NASDAQ
7 with Bunker Ramo Company, who operated it at that
8 time. While he was in law school he worked for -- for
9 me until he graduated.

10 So the -- that's how we got involved in
11 NASDAQ, but as a market-maker we traded basically
12 close to 1,100 securities, all the convertible bonds.
13 And then we got involved in making a market in listed
14 securities, and they encompassed stocks that were
15 traded on the New York Stock Exchange.

16 So we were considered to be one of the
17 largest market-makers in convertible securities in the
18 country and one of the largest market-makers in
19 general, in both listed securities and
20 over-the-counter securities.

21 We had, you know, hundreds of -- of other
22 dealer clients, like Merrill Lynch, Fidelity, Smith
23 Barney. We had directed automatic interfaces for
24 them. Those were our wholesale clients as part of our
25 market-making operation.

1 The proprietary side of the business is when
2 the firm trades with their own account they
3 maintain -- we maintain an inventory, you know, that
4 could be hundreds of millions of dollars on the long
5 side or short side. The firm is trading for its own
6 account.

7 But as a market-maker you also are trading
8 for your own account with the clients, as well as
9 other dealers. But primarily the firm was known as
10 a -- as a market-making firm, a proprietary firm that
11 traded with other brokerage firms.

12 So if you, as a client, would call up
13 Merrill Lynch to buy IBM or to buy Apple computer,
14 they would buy the stock through someone like me. So
15 our clients were basically other brokerage firms, as
16 well as individual retail clients that we had that
17 were people like the Shapiros and the Levys of the
18 world. Those clients, as well as smaller clients that
19 we did convertible arbitrage for as well.

20 And then in the '90s we started dealing with
21 hedge funds that were doing the split-strike
22 conversion or thought they were doing the split-strike
23 conversion trades for us, which was where the fraud
24 perpetuated.

25 Q. Okay. And you mentioned that you had about

1 200 people working in New York and in London?

2 A. Right. Approximately.

3 Q. And was that as of 2008?

4 A. Yes. We -- I think we started the London
5 operation in 1983, and that was also started as
6 primarily a market-making firm in U.S. securities in
7 London.

8 We were either the first or one of the first
9 members of the London Stock -- U.S. firms that became
10 a member of the London Stock Exchange.

11 Q. Okay. But when -- when you -- do you
12 remember when it was that you reached the level of
13 approximately 200 people working in your firm?

14 A. Probably, you know, towards the end. I
15 would say in the -- in the -- in the late 2000s.

16 Q. Okay. Now, when was it that you brought
17 your sons into the business?

18 A. My son, Mark, came in when he graduated from
19 the University of Michigan, which I think was in the
20 mid '80s. My son, Andy, graduated from Wharton, I
21 think in '87 and '88, and he came with us.

22 Q. If you had been doing the fraudulent
23 split-strike conversion in '87 and '88, would you have
24 brought Andy into the business?

25 A. Would I have brought him into the business?

1 No.

2 Q. My question is really, if you were doing
3 something dishonest with your customers, would you
4 have allowed your children to be brought into the
5 business?

6 A. No.

7 Q. Now, I had asked Mr. Goldman to give you a
8 copy of the Lazard report.

9 A. Right.

10 Q. And you've reviewed that, didn't you?

11 A. Yes.

12 MS. CHAITMAN: Okay. I'm going to mark
13 this as Defendants' Exhibit 6, but, at
14 Mr. Sheehan's suggestion, I have put a stamp on
15 the handwritten notes that Mr. Madoff described.

16 And I didn't -- I don't have copies of
17 that, but if you -- if you e-mail it to me, I'll
18 circulate copies to everybody.

19 (MADOFF EXHIBIT 6 WAS MARKED FOR
20 IDENTIFICATION.)

21 MR. SHEEHAN: Okay. Thank you.

22 MS. CHAITMAN: Thank you.

23 BY MS. CHAITMAN:

24 Q. So I'm handing out Exhibit 6, which is the
25 Lazard report. Mr. Madoff, do you -- this is

1 Exhibit 6 for you. I can take those from you.

2 A. Okay. Uh-huh.

3 Q. Before you received a copy of this from your
4 attorney had you ever seen the Lazard report?

5 A. No.

6 Q. Okay. And do you understand that -- what it
7 is?

8 A. Uh-huh, yes.

9 Q. Okay. And this is something that the
10 trustee had prepared when he was trying to sell the
11 market-making and --

12 A. Correct.

13 Q. -- proprietary trading units?

14 A. (WITNESS NODS HEAD UP AND DOWN.)

15 Q. Now, in general did you find that this was
16 an accurate description of the business?

17 A. Yes.

18 Q. So on the page which is Bates stamped number
19 181058, which is the business overview.

20 A. Uh-huh. What -- what page number?

21 Q. It ends in 58. It's in the very beginning.

22 A. 88?

23 Q. 58.

24 A. Oh, 58.

25 Q. 181058.

1 A. Yes, uh-huh.

2 Q. You've got it? Okay. It says, "Business
3 overview"?

4 A. Yeah.

5 Q. It says, "The company's" --

6 MR. SHEEHAN: Where are you reading?

7 I'm sorry.

8 MS. CHAITMAN: The second paragraph.

9 I'm sorry.

10 MR. SHEEHAN: All right.

11 BY MS. CHAITMAN:

12 Q. "The company's market-making operation is a
13 market-maker in approximately 2,100 stocks, including
14 all of the S&P 500 stocks and in over 350 NASDAQ
15 stocks."

16 A. Uh-huh.

17 Q. "It has over 100 direct relationships and
18 several correspondent-clearing clients representing
19 over 1,000 correspondents. The market-maker processes
20 approximately 300,000 to 400,000 tickets per day."

21 Excuse me. "Peak" -- excuse me. "Peak volume of
22 800,000 and capacity up to 1.4 million."

23 "Approximately 80 percent of the trades are
24 in listed stocks, and the remaining 20 percent of the
25 trades are in NASDAQ stocks. Approximately 2.6

1 million shares of the daily volume is for executions
2 of shares not held, and 0.8 million shares of the
3 daily volume is executed with the company's Time
4 Slicing automated system for delivering average price
5 execution. The market-making operation employs 17
6 professionals, including traders and support staff."

7 Is that a fair description --

8 A. Yes.

9 Q. -- of the business as of December 2008?

10 A. Yes.

11 Q. Now, what does it mean when it says, "The
12 company's Time Slicing automated system for delivering
13 average price executions"?

14 A. That was a system that was developed by my
15 sons, Mark and Andy, that was a system that allowed
16 brokerage firms or institutional clients to deliver a
17 large order to us, let's say, to buy 100,000 shares of
18 IBM.

19 And they wanted to -- rather than -- they
20 wanted to execute that order over a certain period of
21 time. So typically those -- the way that was executed
22 by all institutional firms is they would give it to a
23 broker on the floor of an exchange and tell them they
24 want to -- they want to execute this over the course
25 of the day.

1 It was called a VWAP order. It was a volume
2 weighted average price order. But it was a
3 manually -- it was a manual execution, where you were
4 relying upon the specialist on the floor of an
5 exchange or the market-maker upstairs to use his best
6 judgment as to when to execute that order over the
7 course of the day.

8 My sons came up with the concept of rather
9 than doing it that way to -- to allow a firm to take a
10 500,000 share order and give it to us and say, we
11 want, you know, this 500 shares -- 500,000 share order
12 executed every so many minutes. We want it sliced
13 into smaller orders and executed into the marketplace.

14 So they determined the size of the order to
15 hit the marketplace. And in order to do that you had
16 to have the automation, which we were one of the only
17 firms that had that ability. So that was
18 considered -- you know, it was unheard of at the time,
19 to do an executed order like that.

20 Well, my sons developed that order -- that
21 system, Time Slicing, with -- with my brother's,
22 Peter's, help. We then brought it to the SEC and
23 asked -- met with the SEC in Washington approval to --
24 you know, how we would operate this order, and with --
25 did they have any objection to us executing the order

1 this way?

2 At first they looked at us like we were
3 crazy, because no one had ever done that before. And
4 what was necessary was the firm was -- say like
5 Fidelity would be saying, okay, they're -- they're --
6 they're instructing us to execute 500,000 shares of
7 IBM.

8 So they had to trust us that we were not
9 going to run in front of the order, which was a common
10 problem that institutions had with giving up an order
11 to someone, letting them know that you wanted to buy,
12 you wanted to sell their order.

13 So we assured the SEC that that order would
14 be -- was loaded into our system. The only one that
15 would see that order was not any of our individual
16 market-makers or traders, just one supervisor in the
17 firm, which would be either my brother (SIC), Mark or
18 my son, Andy, depending upon which department it was
19 going to go to.

20 And the order would be -- you can look at it
21 like in the old days, when you had computers, and you
22 would load a card -- a bunch of like cards into a
23 sorting thing, and every so many minutes the cards
24 would -- you know, would drop down into the thing and
25 then go into the order.

1 The SEC was so enthralled with this concept
2 of doing it, that they said, yes. They said, if --
3 you know, we'd like you to, you know, build this, if,
4 in fact, you can. We did. We invited them to -- and
5 the head of their market-regulation department to come
6 into our office and watch the system operate.

7 And they -- they said it was terrific. And
8 we -- we, you know, went about selling that option of
9 doing it with any one of our clients. And we had
10 people like Fidelity and T. Rowe Price and any number
11 of our other clients operate through the Time Slicing
12 system.

13 And that was also the forerunner of us
14 developing the Primex system, which is a whole other
15 system that we -- we developed in the '90s, '97 to
16 '98, in a joint effort with Merrill Lynch, Goldman
17 Sachs, Morgan Stanley and Citicorp, where we --

18 There were five partners that we developed
19 my -- developed a -- a trading system called Primex.
20 That was the forerunner of these so-called dark pools
21 that now became very popular, where we were -- we sold
22 a ten percent interest to these five firms.

23 And between the five of us we would account
24 for 50 percent of the volume in the United States
25 between those five firms. It was a big deal in 1998,

1 when it was announced. It was in the front page of
2 all of the financial press.

3 And that was how we planned to operate the
4 split-strike trades through that. Unfortunately, the
5 system once we -- we developed it and took in the
6 partners, it was such a threat to the New York Stock
7 Exchange that the New York Stock Exchange approached
8 us to buy the Primex system for us -- from us, because
9 it was going to be a major competitor to the exchange.

10 We couldn't -- we couldn't agree on terms.
11 So we never sold it to the New York Stock Exchange or
12 took them as a partner, but the New York Stock
13 Exchange, you know, had a history of trying to hold
14 back competition from us.

15 Eventually they negotiated with the -- the
16 partners. You know, made special deals with the --
17 the four partners -- with three of the four partners,
18 Goldman Sachs, Merrill Lynch and Morgan Stanley, to
19 not go forward with it or not -- not send most of
20 their business through that exchange. And they really
21 literally blocked us from -- from really ever
22 fulfilling our desire with that.

23 The -- Citicorp decided that they would buy
24 the -- they would continue with us. So we went on --
25 we were going to develop it with Citicorp in

1 operation, but then my disaster of the investment
2 advisory business sort of, you know -- you know,
3 ruined that -- that whole operation.

4 Q. What did the Primex system do?

5 A. The Primex system was a -- an electronic
6 auction process that would compete with all of the
7 exchanges, like these dark pools.

8 I had been a major competitor for the New
9 York Stock Exchange from the time I started my firm.
10 And which is why -- really how I got involved
11 working -- my relationships with the SEC all of those
12 years.

13 The SEC -- when I went into business, the
14 New York Stock Exchange did 99 percent of all of the
15 business in -- in -- in New York Stock Exchange
16 issues.

17 The SEC had always been unhappy with the
18 fact there was no competition in the U.S. marketplace.
19 So they wanted -- all the business was done between
20 the -- there were five regional exchanges, New York,
21 Chicago, Philadelphia, Pacific, New York.

22 So there were five -- and Cincinnati. Those
23 five exchanges traded all the securities in the
24 United States. Plus there was the over-the-counter
25 market, which became the NASDAQ market.

1 What happened was the SEC and congress was
2 very unhappy with there being no competition in -- in
3 listed securities. So they decided to -- to initiate
4 a -- you know, a competitive marketplace. And they
5 formed a committee, which they asked me to chair,
6 which became the Intermarket Trading System Committee,
7 which was the system of linking all of the exchanges.

8 In other words, it used to be that if you
9 wanted to buy -- IBM traded on both the New York Stock
10 Exchange, as well as five regional exchanges around
11 the country.

12 So you could buy IBM at one price in
13 New York, another place in Chicago, another place in
14 the Pacific. So a customer putting an order in to buy
15 IBM at 11:00 in the morning, or whenever it was they
16 put it in, was in a situation where he may buy the
17 price at IBM at one price in New York, when he could
18 have bought it at a cheaper price, a better price, in
19 Philadelphia or the Pacific and so on.

20 So there was a great arbitrage business that
21 went on, which was, you know, somewhat initiated by my
22 firm, where we would buy IBM in Chicago and then sell
23 it in New York a second later at a -- at a profit and
24 so on and so forth. It was a business that was done
25 by anybody that had an arbitrage operation, not only

1 myself.

2 The SEC obviously realized this was
3 ridiculous. You know, it was unfair to the clients
4 to -- to be able to do that. So they said, look, this
5 is -- you just -- you guys can't operate this way. A
6 customer should be able to get the best price that
7 exists in the marketplace, you know, when he executes
8 the order.

9 So I said, well, how are we going to do
10 that? So they said, well -- they asked me, well,
11 what -- what would you suggest? And I said, well, you
12 could pass a rule that said that if you're going to
13 execute an order for IBM from a client, you have to
14 make sure that the client is going to get it at the
15 best price that existed between the exchanges.

16 And the order has to be routed to, you know,
17 wherever the best price is, whether it's in Chicago,
18 New York, Philadelphia. It doesn't matter. So they
19 said, well, that's -- that's a good idea.

20 I said, well, the problem with that is how
21 is the order going to get -- if the customer is in
22 Chicago, and the best price is in New York, how is
23 that order going to get from Chicago to New York?

24 So they said, well -- so they said, well,
25 yeah. That's true. But how is that going to happen?

1 I said, well, you have to link the marketplaces, so
2 that when the customer starts to -- puts the order in
3 Chicago, and the better price is in New York, the guy
4 in Chicago has to route the order to -- to New York, I
5 said.

6 And you can't do it over the telephone,
7 because that's crazy today. So, you know, we have to
8 build a system that would electronically route it,
9 which became the Intermarket Trading System Committee.

10 So I designed the system with some other
11 firms, with Goldman Sachs at the time, to route these
12 orders, you know, through an electronic routing
13 system, and that was called ITS.

14 So I represented at that time the NASD on
15 that committee. My brother represented the Cincinnati
16 Stock Exchange, which we were the major owners of, the
17 Cincinnati Stock Exchange, which was the first
18 electronic exchange.

19 And the -- I forgot where I -- how I got
20 involved in this --

21 Q. I was asking you about the Primex system.

22 A. Oh, okay. So, I mean, the firm -- we were
23 always competing with the New York Stock Exchange.

24 And at that time I said that the -- that the idea of
25 executing orders on a floor of an exchange is

1 ridiculous.

2 And that nobody is going to, you know, want
3 to, you know, send orders down to an exchange where
4 you have hundreds of people screaming and yelling at
5 each other, you know, when you want to order --
6 when -- when you want to execute an order.

7 The more sensible way to do it is the way
8 NASDAQ operates. And, of course, the SE -- the New
9 York Stock Exchange said, well, Bernie Madoff is
10 always complaining about the New York Stock Exchange,
11 because he built NASDAQ. So he wants all orders to be
12 executed over NASDAQ, rather than the exchange.

13 And I said, well, that's true. I did. And
14 we were a big competitor of the New York Stock
15 Exchange, but it was the most efficient way of
16 executing the orders.

17 And the joke was on Wall Street was that I
18 was always -- they said, Madoff is saying that the
19 New York Stock Exchange is going to be a big roller
20 skating rink before. No one is going to execute
21 orders on the floor of the exchange.

22 And it was true that I did make those kinds
23 of comments. Well, eventually that's what happened.
24 The New York Stock Exchange went from operating 98
25 percent of the business, to now they operate -- they

1 execute 12 percent of the business.

2 And the stocks, when you buy IBM, very few
3 shares are bought on the floor of an exchange.
4 They're bought basically electronically off the floor
5 of the exchange through people like NASDAQ or through
6 these -- these automated dark pools that are
7 operating, what they call the high frequency traders
8 and so on.

9 So the SEC likes to always point out that no
10 good deed goes unpunished, because they blamed me --
11 everybody seems to blame me for developing the
12 electronic marketplaces.

13 So they said that now, you know, you
14 listened to Madoff, and you -- you said you didn't
15 want to operate business on the floor of the exchange.
16 So you allowed the industry to now build an electronic
17 marketplace, where everything is done electronically.

18 And where we used to take 20 minutes to
19 execute an order, it now goes in a millisecond, and
20 there's no basically exchanges being done. And that
21 was very true. I mean, I don't know that you can
22 blame me for that, but that was basically -- you know,
23 it's -- it's true.

24 Q. So the Primex was an exchange?

25 A. Primex was going to be a -- an exchange,

1 where the five of us control 50 percent of the
2 business. Whereas, now -- look, the idea is -- the
3 concept of any -- every brokerage firm wants to keep
4 all of their orders themselves.

5 In other words, Merrill Lynch does not want
6 to share his -- his client's orders with Goldman Sachs
7 or Morgan Stanley or with Madoff. They want to keep
8 their orders what's called in-house or
9 internalization.

10 In other words, when a dealer -- the -- the
11 goal of every brokerage firm in the country has always
12 been to take their customer orders and handle them
13 from beginning to end.

14 They didn't want to -- they didn't like this
15 idea of sharing their orders and their information
16 with everybody in the street. They didn't want
17 competition.

18 Everybody wanted to keep their orders, you
19 know, themselves, but the problem with doing that is
20 the customer gets -- is at a disadvantage of doing
21 that.

22 So -- because the best thing for the
23 customer is to have his orders exposed to the -- to
24 the world in general or the marketplace in general,
25 but it's more efficient for a firm to keep all of

1 their orders themselves.

2 They want to -- they want to buy the stock
3 and sell the stock through their own customers and
4 keep the stock in-house. They don't want to go
5 through clearing corporations or organizations. They
6 want to do everything in-house, because that's the
7 most efficient way to do business.

8 All right. But that comes at a cost, to do
9 that. In other words, it's -- it's very difficult,
10 you know, to do that. You're not exposing the
11 markets -- the orders in general.

12 So there has to be a balance that is
13 developed. So our concept was to allow orders to be
14 executed electronically efficiently and have that --
15 but have that order exposed to the marketplace in
16 general before you execute it.

17 So it's all right to say, okay. We want to
18 keep our customer orders in-house, but we -- we want
19 to make sure that the customer is -- is getting the
20 best price. And how do you do that?

21 The way to do that is to expose the order to
22 the street in general. Say, we're looking to buy IBM.
23 Who is willing to supply the best price? And you --
24 you compete electronically.

25 You have like an auction process. You do

1 that. The -- the technology is there to build it,
2 which we did. So we developed this system called
3 Primex.

4 And we had these five firms, you know, to
5 all agree that before they execute the order
6 themselves in-house the order will go through this
7 electronic auction process.

8 So Madoff, Goldman, Morgan Stanley, Merrill
9 Lynch, Citicorp, Smith Barney would all compete with
10 that order. So before any one of them could -- could
11 execute the order themselves they had to give -- they
12 had to have a bidding process to do that.

13 And that was the system. And it was -- it
14 was, you know, a great system, but, unfortunately, it
15 would be the deathnell to the New York Stock Exchange.

16 And the New York Stock Exchange, you know,
17 tried to buy it from us, but that would have been the
18 end -- they were -- their idea was they'll -- they'll
19 buy it and never operate it, put it on the shelf.

20 But as much as we were able to compete with
21 the New York Stock Exchange and drive them literally
22 sort of out of business, they also killed the Primex
23 system.

24 So we wound up selling part of it to NASDAQ.
25 And NASDAQ operates their opening of the marketplace

1 through Primex, but Primex's big appeal to us would be
2 that we would be able to bring in all of our foreign
3 order flow. You know, the -- all the various
4 exchanges into Primex, and that was how I hoped to
5 eventually handle the split-strike trades.

6 Had Primex gone forward I never would have
7 had this problem. I would have been operating today
8 all the split-strike -- strike trades through Primex.

9 But my brother's -- we have the patent on
10 Primex. And basically everybody that's operating
11 these dark pools around the country today is in
12 violation of patent infringement on Primex.

13 My brother's plan -- maybe this is
14 fantasy -- is when he finishes his ten year sentence,
15 he is going to sue all of these -- basically all of
16 Wall Street for patent infringement on Primex, because
17 all of these dark pools that are operating around the
18 country today, doing all the business, are basically,
19 according to my brother and the patent attorneys,
20 are -- are guilty of a patent infringement on Primex,
21 but we'll see what happens.

22 Q. That's fascinating.

23 Mr. Sheehan had wanted me to ask you a
24 question. I think it's obvious from the way you're
25 answering your questions, but are you on any

1 medication which would prevent you from testifying
2 honestly?

3 A. No.

4 Q. Okay. If you -- if you'd go back to
5 Exhibit 6. It lists on page 64 -- you're on 58. So
6 it goes to 64.

7 A. Okay.

8 Q. It lists the top 20 clients.

9 A. Uh-huh.

10 Q. And they include Citigroup, Brown Brothers,
11 Raymond, Merrill Lynch, Oppenheimer, Wells Fargo,
12 Wachovia, Vanguard, USAA, UBS. Is this an accurate --

13 A. Yes.

14 Q. -- list of the 20 top clients?

15 A. It's the blue bloods of Wall Street.

16 Q. Okay. And then on the next page, which is
17 page Bates numbered 65, it -- in terms of volumes, it
18 said you execute 300,000 tickets a day. Is that about
19 accurate?

20 A. That's on the low side, but, yes.

21 Q. Okay. And you execute 85 million shares a
22 day; is that about --

23 A. Yes.

24 Q. That's accurate?

25 And 80 percent is listed. And if you look

1 at --

2 A. Right.

3 Q. I'm reading from page 65.

4 A. Uh-huh. Yeah, I'm there.

5 Q. Yeah. Okay. I just want you to be on the
6 page with me.

7 A. I have this memorized, all of it.

8 Q. Oh, you do?

9 So it says, "80 percent listed, 20 percent
10 NASDAQ"?

11 A. Correct.

12 Q. Is that accurate?

13 A. Yes.

14 Q. Okay. It says, "2.6 million not held shares
15 a day"?

16 A. Uh-huh.

17 Q. Is that accurate?

18 A. Yeah.

19 Q. What does that mean, not held shares?

20 A. It means it's at our discretion on how we
21 buy and sell. In other words, they -- it's like an
22 order going through Time Slicing, where -- where
23 Merrill Lynch will say, buy 100,000 shares of stock
24 and you determine the price and the time you want to
25 execute the order.

1 Q. Okay.

2 A. They're relying upon our ability to execute
3 it at the best price for the client.

4 Q. Okay. So would you say that the Lazard
5 report accurately reflects --

6 A. Yes.

7 Q. -- the business --

8 A. Uh-huh.

9 Q. -- as of December 2008?

10 A. Yeah.

11 Q. Okay. Now, in the course of your career in
12 the securities business did you -- did you ever come
13 across Bruce Dubinsky?

14 A. No.

15 Q. Did you ever hear of him?

16 A. No.

17 MS. CHAITMAN: Okay. We're going to
18 mark as our next exhibit --

19 MR. GOLDMAN: Why don't you wait until
20 you come back for the microphone?

21 MS. CHAITMAN: Yeah, you're right.
22 What did I do with the Dubinsky report? Hold on.

23 So we're up to Exhibit 7.

24 (DISCUSSION HELD OFF THE RECORD.)

25 (MADOFF EXHIBIT 7 WAS MARKED FOR

1 IDENTIFICATION.)

2 MS. CHAITMAN: Oh, you know what? I'll
3 give this to the witness, and I'll give this to
4 you.

5 THE WITNESS: I already have a copy.

6 MS. CHAITMAN: I'm sorry?

7 THE WITNESS: I have a copy of this
8 one.

9 MS. CHAITMAN: You can just give it to
10 the reporter.

11 MR. GOLDMAN: David, here is one you
12 can look at.

13 MR. SHEEHAN: I'm fine. I brought my
14 own.

15 MR. GOLDMAN: Oh.

16 THE WITNESS: Are you still awake?

17 MR. SHEEHAN: Always.

18 THE WITNESS: The last time we were
19 together, I had a meeting with you, you fell
20 asleep during my testimony.

21 MR. SHEEHAN: Yeah, you warned me about
22 that. I remember that exchange.

23 THE WITNESS: That's okay. I --

24 MR. SHEEHAN: You told me the SEC fell
25 asleep in that meeting too. I remember that.

1 THE WITNESS: I -- I can -- I can put
2 people to sleep. The chairman of the London
3 Stock Exchange fell asleep during one of my
4 meetings with him, but he said it was jet lag.
5 You don't have jet lag. So --

6 MR. SHEEHAN: I have no jet lag.

7 BY MS. CHAITMAN:

8 Q. Mr. Madoff, I had sent you in advance of the
9 deposition a copy of Mr. Dubinsky's report. Have you
10 had a chance to review it?

11 A. Yes, I have.

12 Q. Okay. And did you agree with his
13 conclusions?

14 A. Some of them.

15 Q. Okay. Did you agree with all of them?

16 A. No.

17 Q. Okay. Did you find that overall there were
18 some mistakes that Mr. Dubinsky made?

19 MR. SHEEHAN: Objection as to the form.

20 THE WITNESS: Yes.

21 BY MS. CHAITMAN:

22 Q. Okay. Before we go into detail with respect
23 to the report can you tell me some of the mistakes
24 that you found with Mr. Dubinsky's approach?

25 A. Well, first of all, the majority of the

1 report had to deal with the split-strike conversion
2 trades, which I was sort of at a loss for -- and this
3 report, from what I understand from -- cost a lot of
4 money to -- to produce.

5 And I had from day one acknowledged that
6 there was no split-strike trades being done and that
7 there was a fraud. So I couldn't understand why so
8 much money was --

9 Look, let me just say that from the time
10 that I plead guilty for this -- for this fraud, I've
11 had to live with the guilt of -- of knowing what I
12 did.

13 All right. And my decision basically to --
14 to plead guilty and to not go to trial was to be able
15 to recover as much money as possible to my -- for my
16 clients.

17 And the -- you know, rather than go to -- to
18 trial, which I knew that I was guilty of, and put my
19 family through a -- the horror of, you know, what
20 would -- what would occur with the trial, I -- I
21 decided that the best thing that I could do would be
22 to plead guilty, take my sentence and do everything
23 that I could to recover the money for the clients, who
24 I defrauded.

25 Q. Let me just interrupt you there.

1 When you saw in -- in 2008 that the economy
2 was collapsing, and you had -- you had out-of-ordinary
3 redemptions in 2008; isn't that true?

4 A. Yes.

5 Q. Okay. Would you say that the redemption
6 demand was extraordinary or --

7 MR. SHEEHAN: Object to form.

8 THE WITNESS: Well, yes. I mean, look,
9 unfortunately or fortunately, however you want to
10 look at it, my commitment to the people that I
11 took the money from for the split-strike was that
12 they could have their money back at anytime.

13 In other words, most hedge funds do
14 not -- do not allow people to withdraw their
15 money. They have what they call lockup periods.
16 They -- they say that you have to give them 90
17 days notice, sometimes six months notice before
18 you can get your money back.

19 Because of the way the split-strike
20 strategy was designed there was no reason to have
21 a lockup period if, in fact, I was doing it the
22 way I intended to do it originally.

23 So that people that gave me money,
24 whether it be an individual or whether it be a
25 hedge fund, to invest, had the ability to call me

1 up and say, you know, that they wanted their
2 money back within the settlement period of three
3 days or four days.

4 So when this -- when this bank run
5 occurred with the crisis in 2008, when everybody
6 thought the world was coming to an end, the
7 market was -- was crashing, because of the
8 Lehman -- you know, first Bear Stearns and then
9 the Lehman collapse, everybody needed money.

10 So I was one of the few places that
11 they could -- that a hedge fund could go to -- to
12 demand their money back and not have to wait with
13 a lockup period. So everybody was calling me up,
14 saying, we want -- we need the money, you know,
15 to meet margin calls elsewhere on Wall Street.

16 They needed money back to meet their
17 margin calls on Wall Street. So send me my money
18 back and liquidate the position, and I'll send it
19 back to you to reinvest as soon as things calm
20 down.

21 So I was the -- the one place that they
22 could go to get the money. So I started getting
23 everybody calling me up, you know, send me 500
24 million, send me a billion dollars back. And I
25 did. I started sending the money back.

1 But, obviously, you know, I couldn't
2 keep doing that, because, you know, of the -- the
3 nature of -- of the Ponzi scheme. So I knew
4 that -- that the game was over.

5 As it turns out, I was --

6 BY MS. CHAITMAN:

7 Q. If I could just interrupt you. Do you
8 recall approximately how much money you did send back
9 to customers in 2008?

10 A. Close to six billion dollars.

11 Q. Six billion. Okay.

12 A. But I knew that -- that it was over for me,
13 and --

14 Q. At that --

15 A. As it -- as it turns out, I was mentally --
16 I was in a mental state that I was -- I could no
17 longer continue with -- anyhow. So it was almost like
18 a relief to say, this is it.

19 I just can't continue this charade any
20 longer. And that's what -- that's what caused me to
21 acknowledge to my family that I had been committing
22 this fraud.

23 Q. Okay.

24 A. So, to continue, I decided to plead guilty
25 to this. And when -- before the sentencing my

1 attorneys pleaded with me to cooperate with the
2 government.

3 The government wanted -- the prosecutor
4 wanted me to -- to plea bargain with them to, you
5 know, make some sort of a deal by providing
6 information as to who else was involved in this fraud.

7 I mean, the belief was that I couldn't be
8 doing this all myself, that there had to be other
9 people involved in this fraud. So -- because, look,
10 nobody could understand -- you know, it seems that for
11 the past eight years nobody can figure out why did
12 Bernie Madoff do this?

13 There have been books written about this.
14 Every reporter that's called me, every academic, you
15 know, that's called me from every business school
16 literally in the world, everybody says, why would
17 Bernie Madoff commit the largest fraud in history?

18 Why -- he had a very successful business
19 that was the envy of everybody on Wall Street. He was
20 on all of these committees. He was supposedly boy
21 wonder, of course, you know, of Wall Street at that
22 time.

23 Why would he do this? The SEC was
24 dumbfounded. You can speak to any of the past
25 chairmen over the past eight years and ask them, would

1 Bernie Madoff do this? You know, they would all look
2 at you as though there was something wrong with you.

3 And that's what everybody wanted to know.
4 It didn't make any sense. There had to be something
5 else that created this problem. Was he blackmailed?
6 Was he, you know, involved with -- you know, with the
7 Russian mob? Was he involved with drug dealers?

8 Something happened, you know. You don't --
9 you don't -- you know, and when I said -- you know,
10 when I gave explanations for it, nobody really
11 understood it, you know, but I knew, you know, what
12 happened.

13 I knew, yes, there were people involved that
14 put me in this situation. That being said, it was my
15 fault. I can't blame anybody for -- for what
16 occurred. I mean, I did this knowingly.

17 I was not blackmailed by any -- was not
18 involved with any mob thing. I made a tragic error of
19 judgment that was precipitated by a number of clients
20 that, you know, put me in this situation.

21 That being said, there was not a gun to my
22 head. You know, I could have refused to accommodate,
23 you know, some people that I tried to accommodate.
24 And -- you know, so, therefore, I have the
25 responsibility.

1 So my decision at that time was not to make
2 a plea bargain. I was convinced that I could get the
3 money back that was involved that people lost. I
4 couldn't get the profits back, for sure, but I
5 certainly felt I could recover the principal, you
6 know, back.

7 So -- and I knew that my clients had
8 withdrawn -- many of them over the earlier years
9 before the fraud started that they had -- they had
10 made and -- and withdrew legitimate profits over the
11 years.

12 So I felt that while people were not going
13 to make an average annual return of 12 percent, as
14 they thought that they made, they certainly would --
15 would do all right, and I certainly would be able to
16 recover everyone's principal.

17 So when I told my attorneys that, Ike
18 Sorkin, I said, look, I'm going to recover everybody's
19 money, you know, you know, but I -- I have to do this
20 my way. I can't -- I can't establish a plea. I don't
21 want to make any deal.

22 I said, I'm the only one that really has the
23 knowledge of what happened and what people did to put
24 me in this situation and the wrongdoing that certain
25 people were involved in, I said.

1 And if I go to these people and -- which
2 I've already done to a certain extent anyhow -- and
3 threaten them with -- you know, with their complicity,
4 I said, I'll get the money back. Now, nobody believed
5 that I could possibly do this.

6 MS. CHAITMAN: We're just running out
7 of the tape. So we have to --

8 THE WITNESS: Okay.

9 MS. CHAITMAN: -- take a break.

10 THE VIDEOGRAPHER: Okay. This ends
11 media number one in the deposition of Bernie
12 L. -- Bernard L. Madoff. Going off the record.
13 The time is 11:12.

14 (RECESS FROM 11:12 A.M. TO 11:27 P.M.)

15 THE VIDEOGRAPHER: Back on the record.
16 This begins media number two in the deposition of
17 Bernard L. Madoff. The time is 11:27.

18 BY MS. CHAITMAN:

19 Q. Mr. Madoff, we've been --

20 A. Okay. I --

21 Q. -- discussing a few other things, but I want
22 to come back, if I may, to the Dubinsky report.

23 A. Right.

24 Q. And my question is: Are there some
25 fundamental errors that you feel Mr. Dubinsky made?

1 A. Yes.

2 Q. Okay. Let's -- let's go through them one at
3 a time.

4 A. Okay. All right. Basically what -- well,
5 I'd like to say is that I would -- I'm not going to
6 get involved in his -- the majority of the report that
7 deals with the split-strike conversion trades or
8 whether or not the trades were executed or not,
9 because the -- I have no objection to -- I can't find
10 fault with what he -- what his determination was,
11 because I was not executing the trades.

12 So there's no point in me, you know,
13 evaluating what he says was right or wrong. There may
14 be errors in there, but it doesn't matter. The fact
15 was the errors that I found were -- had to deal with
16 the beginning of the report dealing with the
17 convertible -- the trading that took place before
18 1992, which basically involved the convertible bond
19 arbitrage transactions.

20 So, first of all, let me start by saying
21 that it was quite -- I understand that his -- from his
22 CV that he has a very good CV. All right. In other
23 words, he seems to be -- have his references of fraud
24 reporting or -- I don't find any fault with that. He
25 seems to have a lot of experience.

1 That being said, it became very obvious to
2 me that his knowledge of the market-making and the
3 dealer markets and the over-the-counter trading,
4 whether it be convertibles or so on, there -- he had
5 very little experience in that.

6 And that's not a great surprise to me,
7 because it's sort of a specialized marketplace. And
8 unless, you know, you -- you have firsthand experience
9 of how market-makers operate, how the dealer market
10 works and how the trading of convertible bonds takes
11 place, you know, that's a specialized kind of
12 marketplace.

13 And he had things that were really wrong.
14 For example, he makes the statement that Madoff sent a
15 confirmation to a client, where he -- you know, the
16 client -- he says that the client bought stock or sold
17 stock, which was opposite of what happened.

18 In other words, typically when a retail
19 client gets a confirmation from Merrill Lynch, for
20 example, it states the client bought IBM at a price or
21 sold IBM at a price.

22 When a dealer sends a confirmation to a
23 client, it says, we bought, we sold. Meaning the
24 dealer bought or sold to the client. So, for example,
25 there's a confirmation, and I have a -- a copy of one

1 of our confirmations.

2 Well, I don't need that. In other words,
3 our confirmation says we bought. That means Madoff
4 bought for the customer or from the customer or sold
5 to the customer.

6 Q. Okay. You know what? I don't know if this
7 is going to help you, but --

8 A. Here is --

9 Q. Okay.

10 A. Here is a confirmation. There's a
11 confirmation --

12 MR. SHEEHAN: Let her mark that.

13 MS. CHAITMAN: I will.

14 THE WITNESS: It says in the box, "We
15 sold." All right. Or it would say, we bought.
16 "We," referring to the firm. Madoff.

17 Now, if we had said you bought or you
18 sold, that would be the customer bought. You
19 know -- you know what I'm saying?

20 MR. SHEEHAN: Uh-huh.

21 THE WITNESS: All right. This is a
22 standard dealer confirmation. It also has on
23 here codes, the transaction code and a capacity
24 code. Meaning that it has a number.

25 Meaning what is -- what -- what

1 capacity are we operating? Where -- on the back
2 of the confirmation it says the capacity -- the
3 transaction is transacted over the counter in
4 New York and so on. It also has a capacity code,
5 which is trading as principal or agent and so on.

6 Dubinsky -- okay -- is used to seeing a
7 retail confirmation, which would have the
8 opposite of that. So he makes a big point in his
9 report of saying that Madoff reflected this wrong
10 for the customer.

11 All right. He says that, you know --
12 now, that's -- there's -- nobody that was
13 familiar with the dealer markets would make that
14 kind of a statement. It's -- it's -- quite
15 frankly, it's an embarrassment, you know, to --
16 to put that in the report.

17 All right. He then says that it --
18 this was in violation of his agreement with the
19 customer to act as agent. If you look at the
20 agreements that we have with our clients, and
21 there's a whole series of when a customer opens
22 an account agreement, where there's a trading
23 authorization and so on, it says that Madoff,
24 meaning Bernard L. Madoff, the client is giving
25 Madoff -- is appointing Madoff his agent to

1 transact business for the customer.

2 So it says Madoff is the agent for the
3 customer. It doesn't say that -- you know, so
4 that means that Bernard Madoff, myself, when --
5 he's authorizing me as the only person that is
6 authorized to transact the business with the
7 firm.

8 So the firm is transacting business as
9 principal for their own account, which it clearly
10 states that on the confirmation. He -- this
11 totally confused him for some reason.

12 BY MS. CHAITMAN:

13 Q. Mr. Madoff, can I just stop you for a
14 second.

15 I'm going to show you a statement, but if --
16 if a -- if a customer's statement says bought 100
17 shares of IBM --

18 A. That means the customer bought it on the
19 statement. The statement is showing it as the
20 customer bought. Okay. The statement is assuming the
21 customer -- that he's bought it from Madoff.

22 He knows it, because Madoff is sending the
23 confirmation -- is sending the statement to the
24 customer, saying, you -- he's reflecting the
25 customer -- what the customer bought and sold. It's

1 not reflecting who he --

2 Q. Okay.

3 A. -- bought and sold it from --

4 Q. Okay. So you're --

5 A. -- because we already know that.

6 Q. You're distinguishing between the
7 confirmation and the statements?

8 A. The statement -- yes. The statement is --
9 was -- the statement only shows a transaction on the
10 settlement date. All statements are operated that way
11 with every brokerage firm. The confirmation shows
12 both the trade date and the settlement date.

13 MS. CHAITMAN: Okay. Let me mark as
14 Exhibit 8 the document to which you've been
15 referring.

16 (MADOFF EXHIBIT 8 WAS MARKED FOR
17 IDENTIFICATION.)

18 BY MS. CHAITMAN:

19 Q. And if I can just summarize this, this is
20 dated -- the trade date is October 14th, 2005. The
21 settlement date is October 19th, 2005. And it says --
22 you've crossed out the account number, but it says,
23 "Sold" -- "we sold 42 shares" --

24 A. To the customer.

25 Q. -- "of Wells Fargo"?

1 A. To the customer. Right.

2 Q. Okay. So, "we," is Bernard L. Madoff?

3 A. Right.

4 Q. So -- so let me just understand something.

5 So if the customer was buying 42 shares of Wells

6 Fargo, you wouldn't go into the marketplace and -- and
7 buy it for the customer?

8 A. Well, we -- we could, but we buy it -- we'd
9 go into the marketplace and buy it for our own account
10 and then resell it to the customer.

11 Q. Okay.

12 A. That's how principal trades work.

13 Q. Okay. As a general statement with respect
14 to the investment advisory customers --

15 A. Uh-huh.

16 Q. Now, obviously from whenever in 1992 you
17 stopped executing split-strike trades, there weren't
18 any purchases and sales?

19 A. That's correct.

20 Q. So --

21 MR. SHEEHAN: Object to the form.

22 Sorry. What I'm going to do in the future is
23 just say form or object.

24 MS. CHAITMAN: That's fine. It doesn't
25 matter.

1 MR. SHEEHAN: I don't want to interrupt
2 the flow.

3 MS. CHAITMAN: Yeah, that's all right.

4 BY MS. CHAITMAN:

5 Q. I want to exclude the period after you
6 stopped executing trades that were reflected on the
7 statement. So whenever that was. Okay. Whether --
8 you know, whatever month of --

9 A. Okay.

10 Q. -- 1992 it was. Let me take the time before
11 that.

12 A. Yeah. Well, he's -- the Dubinsky report
13 that was making the statement of a trade that was a
14 convertible bond trade that was actually made. So the
15 example he's using -- he's not talking about a
16 split-strike.

17 He's talking -- he's saying that -- on the
18 convertible bond trade didn't really exist, because
19 Madoff's confirmation is incorrect.

20 Q. Okay.

21 A. So --

22 Q. So let me -- so let me just try to
23 understand something. I want to take the period -- I
24 want to limit my questions and your answers to the
25 period when you -- before the split-strike fraud

1 began.

2 A. Correct.

3 Q. Okay. So we're going to go earlier than
4 whatever date that was in 1992, when the split-strike
5 trades were not executed.

6 A. And the Dubinsky report that's making this
7 statement is referring to a convertible bond trade
8 that was in the period that you're talking about.

9 Q. Okay. So as to the convertible bond trades,
10 is it generally true that the customers were buying
11 from Madoff and selling to Madoff?

12 A. Correct. From Madoff's inventory that he
13 already had or that he just bought or sold.

14 Q. Is -- is that true for everyone in the --
15 if -- if I take the convertible --

16 A. Operating as a dealer. Yes.

17 Q. So with your investment advisory customers,
18 who were doing convertible arbitrage --

19 A. Uh-huh.

20 Q. -- their transactions always were with
21 Madoff?

22 A. Correct.

23 Q. So --

24 A. All of our customers -- we always traded
25 for --

1 Q. From your own inventory?

2 A. Other than theoretically in options, we
3 traded from our own inventory.

4 Now, again, a dealer operates -- you -- a
5 customer may tell the -- we may decide to sell stock
6 to a customer or buy stock from a customer.

7 Now, we may already have that stock in our
8 inventory, and we're selling it to the customer from
9 inventory or the customer may -- we may not have the
10 stock in inventory.

11 So we have to go out and buy it into -- from
12 Wall Street, from the marketplace, into our inventory
13 and then resell it to the customer. So that might
14 happen over a period of the same day or it might
15 happen over a period of a week and so on.

16 Which brings me to the next point. Okay?
17 That --

18 Q. Can you -- can you remember that? Because I
19 have a question about this.

20 A. Okay. Go ahead. Then give me that then.

21 Q. Give me a word, so I can remind you about
22 your next point.

23 A. I'll remember.

24 Q. You promise?

25 A. Yes.

1 Q. Okay. So -- so let's say that in the
2 convertible arbitrage strategy you had a need for
3 5,000 shares of IBM, because you were going to sell
4 them to the convertible arbitrage customers.

5 A. Right.

6 Q. Okay. Mr. Dubinsky was looking for the
7 purchase of 5,000 shares of IBM on a specific date in
8 the market; right?

9 MR. SHEEHAN: Objection.

10 THE WITNESS: Uh-huh.

11 BY MS. CHAITMAN:

12 Q. Is that what he should have been doing?

13 A. I'm not sure I understand your question.

14 Q. Okay. Well, let me start it over again.

15 Dubinsky made the point in several instances
16 that with the convertible arbitrage strategy the
17 statements all together showed more purchases of a
18 particular security than he could find records for --

19 A. Okay.

20 Q. -- on the New York Stock Exchange.

21 A. Okay. All right. So that's a -- that's a
22 different subject, but -- all right. He -- if
23 we're -- he -- what Dubinsky was -- was trying to
24 establish or -- was that the -- the number of bonds
25 that we -- let's say convertible bonds, because we're

1 talking about convertibles, because we're referring to
2 bonds rather than stock.

3 Q. Okay.

4 A. Okay? So Dubinsky is claiming that if we
5 show on a confirmation or in a customer account that
6 we bought stock -- we sold stock to a customer or
7 bonds to -- to a customer, that he looks to try and
8 establish that there weren't enough bonds that
9 actually traded in the marketplace at the time that we
10 claim that we bought the bonds for the customer.

11 All right. So the way he researches that is
12 he looks on the New York Stock Exchange, you know,
13 number of bonds that traded on the New York Stock
14 Exchange, and shows that that was, let's say, 100
15 bonds, and Madoff bought 200 bonds for a customer.

16 So, therefore, he couldn't have possibly
17 bought 200 bonds for a customer, because only 100
18 bonds traded on the -- on the New York Stock Exchange.

19 All right. Now, the -- the fallacy of that
20 is that, number one, convertible bonds, which is what
21 he's researching here, do not trade on the New York
22 Stock Exchange. They trade over the counter.

23 And to demonstrate that I happen to -- I
24 brought this. This is a very expensive book, I was
25 told. I happened to find it in the library here, for

1 some strange reason. It's the -- it's the Bible of --
2 of the bond markets. All right.

3 MR. GOLDMAN: Tell us the title, so we
4 have it.

5 THE WITNESS: It's the, "Bond and Money
6 Markets: Strategy, Trading, Analysis."

7 BY MS. CHAITMAN:

8 Q. And who is the author?

9 A. Moorad Choudhry or something of that sort.

10 MR. SHEEHAN: Could we have the
11 spelling of that since we won't be able to take
12 the book with us?

13 THE WITNESS: Moorad --

14 MS. CHAITMAN: Okay. So the -- the
15 book is written by, M-o-o-r-a-d, and then his
16 last name is, C-h-o-u-d-h-r-y. And it's
17 published by Butterworth-Heinemann Finance, and
18 it's called the, "Bond and Money Markets."

19 MR. SHEEHAN: What edition is it?
20 Sorry. So I don't want to have the wrong book.

21 MS. CHAITMAN: You know what? I'll let
22 you look at it. It -- it's -- it's first
23 edition.

24 MR. SHEEHAN: Okay. Fine.

25 MS. CHAITMAN: First edition.

1 THE WITNESS: All right. You know, I
2 happened to have made a copy of this. It's
3 discussing the secondary market, which is
4 what's -- you know, when you -- when you buy and
5 sell stock for clients, you're buying in the
6 secondary market, as opposed to the primary
7 market.

8 The primary market is when a company
9 goes public, they sell stock in the primary
10 market. All right. Then after the company sells
11 that stock to the public, it then trades -- the
12 stock trades for the rest of the -- its life in
13 the secondary market. All right.

14 MR. GOLDMAN: Bernie, you keep saying,
15 "stock." You mean bond too; right?

16 THE WITNESS: Same thing.

17 MR. GOLDMAN: Okay.

18 THE WITNESS: You know. So, you know,
19 it basically is talking about -- you know, this
20 section was -- was talking about convertible
21 bonds.

22 It says here -- it says, "Corporate
23 bonds virtually everywhere are traded on an
24 over-the-counter, OTC, basis. That is directly
25 between counterparties over the telephone."

1 Meaning people like Madoff.

2 "Bonds are usually listed on the
3 exchange." I'll read what it says. "On the New
4 York Stock Exchange a low volume of trading in
5 bonds takes place on the exchange itself, but
6 this is dwarfed by the volume of trading in the
7 bonds in the over-the-counter market."

8 In other words, what they're stating is
9 that, although, this is a bond that is listed on
10 the New York Stock Exchange, you know, most of
11 the trading takes place in that bond in the
12 over-the-counter market.

13 It's a listed bond. So you can buy it
14 on the New York Stock Exchange, but no one does
15 that. It's traded over the counter. So
16 Dubinsky, you know, looks -- when he looks -- for
17 example, it would be the same thing if he looked
18 on the equity side of the market.

19 Let's say in -- in a split-strike
20 trade. If he looked in -- because IBM trades on
21 the New York Stock Exchange, if you just looked
22 at the volume on the New York Stock Exchange to
23 try and account for that -- for the customer
24 trading, if the customer traded in the
25 over-the-counter market, which is where we trade,

1 and where everybody else trades today, where it
2 used to be 99 percent of the market, as I said
3 earlier, traded on the floor of the exchange, now
4 ten percent trades on the floor of the exchange,
5 and the rest of it trades everywhere else.

6 And the convertible bonds have always
7 been that way. In other words, so that Dubinsky
8 looks at the -- in order to say, well, Madoff
9 says he bought 200 bonds for a client.

10 Now, I'm looking on -- you know, in his
11 report. He -- he looks on the New York Stock
12 Exchange, and clearly he sees that that doesn't
13 match.

14 He's ignoring the over-the-counter
15 market. Even though in one of his examples it
16 says the bond trading on the New York, and then
17 it also says OTC market.

18 But bonds -- that was the price range
19 he was trying to establish in that. There is --
20 if you spoke to anybody that knew anything -- you
21 know, and I'm not trying to be -- I'm not trying
22 to, you know, be sarcastic with him, but if you
23 spoke to any other person, you know, that -- that
24 understood how the markets work, and you said,
25 I -- I just looked at the New York Stock

1 Exchange, and he said, well, wait a minute.
2 Nobody trades bonds on the New York Stock
3 Exchange. They trade them in the
4 over-the-counter market.

5 So, you know, that was to me sort of
6 surprising, that anybody would do that. It -- it
7 demonstrated, you know, a total lack of
8 understanding.

9 Again, this is not -- I don't want to
10 be unfair to the man. I've had 50 years of
11 experience dealing in things like this, where
12 people who, you know, understand -- I wouldn't
13 understand how lawyers operate.

14 Okay. So if you asked me how I'm
15 supposed to give a deposition or anything else, I
16 would not know. Of course, now I'm becoming an
17 expert on that also, but it would not be -- I
18 wouldn't -- you know, it wouldn't mean that --

19 I'm not saying Dubinsky is not a smart
20 guy. He may be a very smart guy. He -- his CV
21 is very good, but I've -- I've dealt with tons of
22 people that are smart people and are experienced
23 people, but, you know, it's like a brain surgeon
24 going to a dentist for -- to have a brain surgery
25 done.

1 All right. So, to get back to your
2 statement, his -- his lack of understanding how a
3 confirmation in a dealer market works, which is
4 clearly a mistake, or where the volume were
5 traded is another mistake.

6 He -- he goes on to make another
7 mistake when he talks about the price range.
8 Now, that's a little bit more complicated. Now,
9 all of our transactions are -- are what's called
10 average price transactions.

11 If you look on the back of my
12 confirmation -- I'm going to take this for a
13 second again -- it states, "Customer equity
14 transactions" -- because this is an equity, being
15 it says -- so it doesn't matter. It would be the
16 same thing with bonds.

17 It says, "As per your authorization and
18 instructions, we have executed this transaction
19 for your account."

20 All right. It says, "Unless stated
21 otherwise on the front of this confirmation, the
22 trade price of your transaction is an average
23 price and includes a commission equivalent of
24 four cents per share markup. Full details of
25 this transaction on request."

1 In other words, an average price
2 transaction is when we buy stock for a customer
3 or, you know, we buy stock. We -- we may start
4 buying the stock on a Monday, and we may buy that
5 Monday, Tuesday, Wednesday, Thursday, Friday. So
6 we may buy a -- 1,000 shares over a period of
7 three days, four days or five days.

8 We start on a Monday. We may finish on
9 a Friday. That's typically because we're buying
10 a large amount of bonds or stock for a client.
11 And we may start buying the -- let's say, the
12 bond at 98, and then we may wind up paying 100 by
13 the time Friday is, because as the market moves.

14 So we're accumulating stock, a number
15 of shares or bonds, over an average number of
16 days at an average price.

17 So if we start buying a bond, let's
18 say, at 98, and we wind up finishing buying it at
19 100, as the market moves up, we bought stock --
20 the bonds at 98, 99, 99 and a quarter and so on
21 and so forth.

22 When we report the trade for the
23 customer on Friday, which is when we're finished,
24 we may have paid 90 -- 99 and three-quarters on
25 the bond. All right. What Dubinsky -- you know,

1 that was the average that we accumulated for the
2 customer.

3 Now, the 99 and three-quarters was
4 bought over a period of three days. If -- if you
5 look at -- if he looks at the price, the range of
6 the stock, the price on the day that appears on
7 the confirmation, it may show 100, which was
8 where this -- the closing price was on that day.

9 All right. But, you know, we may -- we
10 may sell it to the customer at 99 and
11 three-quarters, which was the average price of
12 that stock. He -- he thinks that that's a
13 mistake.

14 How could we have bought the stock for
15 the customer at 99 and three-quarters, when it
16 shows that -- it shows that the cheapest price
17 the stock traded was 100.

18 So he's saying that Madoff is -- is
19 buying stock cheaper than he could have bought it
20 in the marketplace. He's not accounting for the
21 fact that we started buying it, you know, three
22 days.

23 In other words, it wasn't -- he thinks
24 it was all bought at one price on that day.

25 Okay. If he -- if he bothered to read the back

1 of the confirmation, which he probably never did,
2 you know, it clearly states that these are
3 average price transactions. They're not one
4 price.

5 Okay? We're --

6 MR. SHEEHAN: I just have a little
7 housekeeping.

8 MS. CHAITMAN: Yeah.

9 MR. SHEEHAN: I'd like -- he read from
10 that. I'd like to get that marked. That.

11 MS. CHAITMAN: This -- this marked.

12 MR. GOLDMAN: The photocopy.

13 MR. SHEEHAN: And his notes too. He's
14 reading from notes.

15 THE WITNESS: This is just --

16 MS. CHAITMAN: That page. Okay. Good.
17 Okay. So I'm going to mark as Exhibit 9, this is
18 a page from the volume that we've just described.
19 It's page 323.

20 MR. SHEEHAN: Great. And I think he
21 had his notes that he was reading from too.
22 So --

23 MS. CHAITMAN: Did you have notes that
24 you were reading from?

25 MR. SHEEHAN: Yeah.

1 MR. GOLDMAN: Yeah, there was.

2 THE WITNESS: Where did I put them?

3 MS. CHAITMAN: Were there -- I did mark
4 notes before. Are there new notes? I didn't
5 notice.

6 MR. SHEEHAN: Yeah, there were notes
7 that were part of the --

8 THE WITNESS: Here they are.

9 MS. CHAITMAN: Okay.

10 MR. GOLDMAN: There they are.

11 MS. CHAITMAN: Can I mark that?

12 THE WITNESS: You can have it, but it's
13 my only copy. Okay. I am not finished with it
14 yet. So don't -- don't take it.

15 MS. CHAITMAN: No. I'm not taking it.

16 (MADOFF EXHIBIT 9 WAS MARKED FOR
17 IDENTIFICATION.)

18 MS. CHAITMAN: I'm going to mark as
19 Exhibit 10 some handwritten notes that Mr. Madoff
20 has been referring to, and I'm going to give it
21 back to Mr. Madoff.

22 (MADOFF EXHIBIT 10 WAS MARKED FOR
23 IDENTIFICATION.)

24 MR. SHEEHAN: For the record, there's
25 notes on the back of that page too.

1 MS. CHAITMAN: Yeah, yeah.

2 MR. SHEEHAN: That'll be fine.

3 MS. CHAITMAN: But it's all one
4 exhibit.

5 MR. SHEEHAN: Yes. It is one exhibit.

6 MS. CHAITMAN: Yeah.

7 THE WITNESS: Okay. So --

8 BY MS. CHAITMAN:

9 Q. So let -- just to catch up. One mistake he
10 made was not understanding that on the trade
11 confirmations it -- Madoff -- the firm is buying -- if
12 it says, "bought," it means Madoff, the firm, bought?

13 A. It means that -- it means -- yes. The,
14 "we," refers to the firm, Madoff, bought from the
15 customer or sold to the customer.

16 Q. To the customer. Okay. And -- and sold
17 from the firm's own inventory?

18 A. That's correct.

19 Q. Okay. And then you've made the point that
20 Dubinsky looked for confirmation of the volume on the
21 New York Stock Exchange or the London Stock Exchange,
22 and, in fact, the convertible bonds were not sold on
23 the -- you didn't buy them on the --

24 A. We traded in the over-the-counter market.

25 Q. Right.

1 A. And there was not even volume reported -- in
2 the days -- the period of time he's looking for there
3 was no volume -- actually, the majority of the volume
4 was never reported in the over-the-counter market,
5 because there was no volume requirements to report
6 volume in bonds in the over-the-counter market until a
7 later date.

8 Q. Okay. Do you --

9 A. It was very -- it was a very -- I don't --
10 it was very hazy, the -- the volume reporting
11 requirements on -- on bond -- in the bond market was
12 never really -- it was that way -- to this day it's
13 sort of a gray area.

14 Q. Okay. All right. Now -- now you want to
15 go -- do you have another area that you want to cover?

16 A. We've covered the confirmations and the
17 statements, and we've covered the volume, and we've
18 covered the price. So basically what I'm saying is
19 his -- his criticism of the price of the volume and of
20 the confirmations and statements are inaccurate.

21 Q. Now, Mr. Dubinsky says that there's no proof
22 that the bonds were converted.

23 A. Okay. A -- the -- the typical strategy on
24 convertible bonds is not to convert. In other words,
25 nobody in their right mind should ever -- if a

1 convertible bond exists, you would never buy the
2 stock, as opposed to buying the bond, if you could buy
3 the bond at a discount.

4 In other words, a convertible bond trade --
5 a convertible bond -- let's say a bond is convertible
6 into 100 shares of stock at \$10 a share. All right.
7 The -- the convertible bond always should trade at a
8 premium above what it's convertible into the price of
9 the stock at, because it has a coupon attached. It
10 pays interest.

11 So convertible bonds typically trade at a
12 premium. In other words, the bond theoretically would
13 be worth 100 based upon the price of the stock at ten.
14 The bond should always trade above 100.

15 It should trade at 101, 100 and a half and
16 so on, because of the fact that the convertible bond
17 is always -- is always going to be worth more than the
18 stock, you know, because of the coupon that it has to
19 it.

20 So convertible bonds sometimes trade at a
21 discount, but rarely. Usually they trade at a
22 premium. All right. When you combine a bond at -- a
23 convertible bond at a -- at a discount, you could
24 theoretically buy the bond, let's say, at 98, when it
25 really should be selling at 100.

1 All right. Because you could buy the bond
2 at 98. Sell the stock at ten. Would be -- you'd make
3 a two point profit by converting it. So ideally you
4 would say, okay. If you -- because then you'd have no
5 risk.

6 You'd immediately buy the bond at a
7 discount, sell the common stock simultaneously at a
8 profit, and then convert one into the other. You
9 exchange the bond by selling -- sending it to the
10 conversion agent and say, here is your bond back. You
11 know, I want stock back. And then you'd deliver the
12 stock out, and you'd make a profit.

13 But most bonds trade at premiums, which is
14 what they shouldn't be doing. All right. So the
15 typical strategy of a convertible bond trader would be
16 to -- to buy the bond either at a discount, which
17 allows you to convert it immediately and make a
18 profit, or hold the bond open and wait for the bond to
19 go to a premium, where it historically should trade
20 at, and then you sell out the bond, cover the stock
21 and un -- what's called unwinding the transaction.

22 Which Dubinsky in his report does state that
23 that is one of the -- he has that right. That that is
24 the -- you do that kind of trading, you know, either
25 buying it and converting it or unwinding the

1 transaction. He acknowledges -- he has that -- that
2 part right.

3 He doesn't go into the fact that most bonds
4 should not be converted, but anybody that is familiar
5 with convertible bond trading would know that.

6 All right. The -- so what Dubinsky then
7 does is he says that Madoff, you know, who -- who did
8 buy bonds at a discount and sell the stock, you know,
9 accordingly, it had a locked-in profit, he never
10 physically converted -- he never sent the bonds in to
11 be converted, you know, and take the profit that way,
12 which he should have -- he should have done, you know.

13 But he said, there's no evidence that he
14 ever put the bonds into conversion, because typically
15 he would have found in our records, he assumes, some
16 sort of instructions to the conversion agent to
17 convert the bonds into stock.

18 All right. And if, in fact, we did that, he
19 would -- he would find those instructions, but our
20 strategy, as he acknowledges, as most people's
21 strategy would be, to -- to not convert. He doesn't,
22 you know, really go into the details of that.

23 So our strategy is basically buy the bond,
24 sell the stock. And even though we have a profit and
25 could convert it and lock in the profit, is we don't

1 convert it. We hold it open, and then we undo the
2 whole transaction when the premium goes back to where
3 it should be.

4 As a matter of fact, when David Kugel was
5 first hired by me his job was to track all of the
6 convertible bonds that traded in the marketplace. And
7 we had a -- a whole spreadsheet that -- that we
8 developed for him that tracked what every bond that
9 was trading in the marketplace historically traded at.

10 So it would look and see that -- let's say
11 IBM bonds traded over this past two years always went
12 to a two point premium. It always traded at a two
13 point premium.

14 You know, every now and then it -- it would
15 go to a -- a discount or a one point premium, and
16 then, you know, it would go back to that premium. So
17 we would track them historically.

18 And we would always look to see when the
19 bond was -- you know, was changing its relationship.
20 And then we would go into the marketplace and buy
21 those bonds. And that's what all convertible bonds
22 traded, but that was our specialty, was trading this
23 way.

24 All right. But anybody that was a good
25 convertible bond trader did the same thing. It was

1 not unique to us. We happened to do more of it than
2 most people.

3 All right. So our goal was to not convert.
4 It was -- it was basically to unwind the transaction.
5 All right. So because he -- he could never see that
6 we were actually converting, and -- and he did find
7 some that we converted, but not -- you know, but there
8 were instances -- he made the assumption that we would
9 always convert, and that -- that's totally untrue.

10 All right. Because what we would do would
11 be when -- when the premium went to where we expected
12 it to go to, we would, what's known as, unwind it or
13 swap the transaction, which another dealer that had
14 the transaction.

15 The problem -- the customer would make -- he
16 could make more money theoretically, you know, within
17 what we -- than what he made had we actually converted
18 it. He could make a greater profit or he could make
19 the same profit. It didn't matter.

20 But as a dealer our goal was to keep bonds
21 out of conversion, because the more you kept the bonds
22 out of conversion, you kept them open in the
23 marketplace to trade at a -- at a future time.

24 So -- because once you convert a bond it's
25 out of existence any longer. So the goal of all

1 traders is to keep these bonds in circulation. So you
2 could --

3 It would be like if a customer -- if
4 everybody took the stock that they bought, and they --
5 and they -- the company bought back more of their
6 stock, when a company, like IBM, buys back their stock
7 in the marketplace, they're taking it out of existence
8 anymore. Nobody can trade that stock. So everybody
9 wants to keep these bonds in circulation.

10 All right. Now, another mistake that he
11 makes is if, in fact, we did convert -- you know, he
12 makes the assumption that we would physically put the
13 bonds ourselves into conversion, which, you know, I
14 can understand him thinking that we would do that.

15 All right. But he makes the assumption that
16 because he didn't see any instructions from Madoff to
17 the conversion agent, that we didn't convert.

18 What he seems to not understand, which I can
19 understand him not understanding, is we had -- he
20 thinks our only bank was J.P. Morgan and Bank of
21 New York, which -- in the 2000's those were our main
22 banks.

23 J.P. Morgan was our primary bank when we
24 were dealing with customers in split-strike, and our
25 operating bank when we were dealing with our

1 market-making and dealer in -- in general, doing
2 hundreds of thousands of trades, were handled through
3 Bank of New York, which was our operating bank.

4 All right. In the period that he's looking
5 at the convertible bonds in the '70s and the '80s, we
6 had -- our banks were Chase Manhattan Bank,
7 Continental Bank, Commercial Bank of North America,
8 Meadowbrook National Bank, Marine Midland Bank.

9 You know, we also had clearing arrangements
10 with -- with Barclays, with Carlo LaBorde (PHONETIC) &
11 Company, Edwards & Hanley (PHONETIC) and others. In
12 other words --

13 Q. Bear Stearns?

14 A. Huh?

15 Q. Bear Stearns?

16 A. Bear Stearns. So he like -- he doesn't see
17 any of that, because he wouldn't. He's looking at --
18 you know, in the -- in the more recent period those
19 banks have already been merged out or don't exist any
20 longer.

21 You know, when we -- when we did convert
22 bonds -- and we did convert bonds, you know. We
23 didn't -- you know, the -- the majority of what we
24 unwound, but we looked -- when we did convert a bond,
25 we would convert the bond through one of those agents,

1 like Commercial Bank of North America, because if the
2 bank's conversion agent was in Chicago, and we wanted
3 to convert it, we would have -- we would have had
4 to either send somebody out to Chicago or a messenger
5 to convert the bond or mail it and hope that the
6 mail -- the bonds actually got there.

7 You would never do that. You would -- you
8 would give it to a bank, you know, and the bank would
9 convert it for you. So we would give it to the
10 Commercial Bank of North America.

11 They had -- they were a large clearing bank,
12 and they would physically convert it with arrangements
13 through whoever the conversion agent was doing that.

14 All right. He doesn't -- he has no way of
15 knowing that, because those banks weren't -- he
16 doesn't even know those banks existed when they were
17 there. So the banks themselves, which we would
18 convert, would -- would draft out.

19 It was the same thing like when we would
20 deliver -- before we formed the clearing corporation
21 on equities, if you sold stock to a brokerage firm in
22 Chicago, in order to get paid for that you would have
23 to mail that stock to Chicago and hope that they sent
24 you a check while the bank -- you know, when they
25 finally got it.

1 All right. As opposed to when we developed
2 a clearing corporation, meaning the National
3 Securities Clearing -- Clearing Corporation, NTTC, you
4 know, we would -- they would clear the whole
5 transaction.

6 So it would -- you know, of course, the
7 industry -- another thing I got blamed for was
8 founding the clearing corporation, because Wall Street
9 cleared all of their transactions through basically a
10 couple of major banks, like Citicorp, Chase and so on.

11 Nobody -- they handled -- they -- brokerage
12 firms themselves didn't all have the facilities --
13 back office facility. So a bank used to clear those
14 trades for them. The banks -- that was a great
15 business for banks.

16 So the industry, because of the paperwork
17 crisis, decided they had to have a -- they had to have
18 a clearing corporation developed to clear the trades
19 for the industry.

20 The major banks in the United States went
21 crazy with that concept, because they wanted to keep
22 all of the business themselves. They wanted brokerage
23 firms to be required to -- to use the banks to clear
24 the transactions rather than have a clearing
25 corporation.

1 But finally we -- you know, the SEC put
2 enough pressure on people to develop a clearing
3 corporation. So we formed the National Securities
4 Clearing Corporation, which I became the chairman of.

5 And then we merged also Depository Trust
6 into that. So that brokerage firms would send their
7 deliveries of stocks rather than through the mail,
8 where you have to use the bank to do that, to use a
9 clearing corporation, which settled all of the trades
10 for the whole industry.

11 So what -- what happens today -- I'm telling
12 you more than you probably are interested or wanting
13 to know, but if I -- I may buy stock -- you know, sell
14 10,000 shares to Merrill Lynch and 10,000 shares to
15 someone else and so on and so forth.

16 And buy and sell all day long with -- you
17 know, like we did hundreds of thousands of
18 transactions as -- as the report points out. The
19 clearing corporation nets all of these transactions,
20 you know, among the Wall Street brokerage firms.

21 And at the end of the day they net out -- I
22 may have bought and sold a million shares during the
23 day, but the net comes out to 500 shares between all
24 my buys and sells.

25 They send me a bill at the end of the day

1 that I either have to pay on the 500 shares or get a
2 check for the 500 shares of stock. And all of the
3 banks went out of the clearing business, and now it's
4 all handled by the National Securities Clearing
5 Corporation Depository Trust.

6 Q. Okay. I want to go back, because that's one
7 of the things that Dubinsky talks about, that he can't
8 find trade confirmations. Now, we're dealing with --

9 A. So --

10 Q. -- the convertible arbitrage strategy --
11 strategy in the 1980s.

12 THE COURT REPORTER: Can I ask for a
13 break?

14 MS. CHAITMAN: Of course. Of course.

15 THE VIDEOGRAPHER: Going off the
16 record. The time is 12:09.

17 (RECESS FROM 12:09 P.M. TO 12:16 P.M.)

18 THE VIDEOGRAPHER: Back on the record.
19 The time is 12:16.

20 THE WITNESS: Okay. So I think we were
21 at the -- the clearing of -- oh, so that his
22 inability to find instructions to convert bonds,
23 you know, all the time was that he was not aware
24 of the fact that if we did convert bonds we had
25 the ability and did convert bonds through other

1 clearing -- other clearing banks.

2 BY MS. CHAITMAN:

3 Q. So that you wouldn't have the records for
4 that?

5 A. Wouldn't -- they would not exist, because
6 there would be no way that we would put the bonds
7 physically for the most part -- we did some -- some of
8 them, depending upon what the year it was and what he
9 was looking for, but, as I say, the idea was not to --
10 to actually convert, but --

11 Q. Right.

12 A. -- to arrange a swap arrangement --

13 Q. Right.

14 A. -- or a clearing arrangement.

15 Q. Okay. Now, he also makes the point that he
16 couldn't find trade confirmations.

17 A. Okay. That -- when -- one of the times
18 that -- when you first came down, if you still
19 remember --

20 Q. And when you say, "you," are you --

21 A. Meaning David Sheehan --

22 Q. Sheehan.

23 A. -- and his staff of attorneys came down
24 here. I think it was at that time that they mentioned
25 to me that they could not find confirmations --

1 counterparty confirmations on transactions.

2 So -- and we were buying and selling stock
3 through other brokerage firms for clients. They
4 expected us to -- they saw that we had confirmations
5 selling and buying stocks from the customer, but they
6 did not find any confirmations to the broker.

7 All right. Now, number one, if we were
8 dealing as principal, which clearly our confirmations
9 stated, and we always did it as principal, we would --
10 there wouldn't be a counterparty on the other side of
11 the trade, because we were the counterparty on the
12 other side of the trade.

13 But when we did go out into the street to
14 buy the stock, you know, there would be a
15 counterparty, you know, on the other side of the
16 trade. He couldn't find the confirmation. So he saw
17 thousands of confirmations with clients, but he never
18 saw any broker confirmations, period.

19 So he said to the -- you weren't buying and
20 selling stock from anywhere. You know, there were no
21 confirmations. And I looked at him, and I said, well,
22 no. You know, I was sort of -- didn't understand the
23 question, because I didn't understand why he expected
24 there to find confirmations.

25 Q. When you say, "him," to whom are you

1 referring?

2 A. The trustee.

3 Q. Okay.

4 A. And -- so it was that -- you know, I then
5 realized that, you know, he expected to find -- you
6 know, just as he found a broker confirmation, he
7 assumed that every time we went and sold or bought
8 stock from a customer we bought it from another
9 broker, which sometimes we did.

10 Sometimes we bought it out of inventory. If
11 it was bought out of inventory, there wouldn't be --
12 there would be a customer confirmation at an earlier
13 date that -- that we put it into our inventory, but --

14 All right. But, I said, there -- there are
15 no confirmations. And that sort of went on deaf ears.
16 Now, number one, I said, first of all, you're looking
17 at -- we don't -- we don't keep any records of
18 customer confirmations from the past six years.

19 I said, the record retention period for the
20 industry is six years. So after six years everybody
21 gets rid of all of their records. You can imagine, we
22 do hundreds of thousands of trades everyday.

23 If we -- if we kept paperwork for all of
24 those transactions, you know, it would be impossible.

25 I said, so we keep customer confirmations for, you

1 know, a longer period of time, because customers need
2 that for tax purposes, audits and so on and so forth.

3 But a general policy, we don't keep records
4 for more than six years, because that's what the
5 record retention period does. Even though we did have
6 records, because -- and I used to always yell at my
7 people.

8 I used to say, after six years, get rid of
9 everything, because I'm paying for storage on this
10 stuff. But I said, wait a minute. I said, you
11 won't -- you won't find confirmations for any of my
12 trades.

13 I said, I do hundreds of thousands of
14 shares -- of trades everyday. I said, you don't
15 find -- you can't find any of those confirmations. I
16 said, so are you now assuming because you can't find a
17 confirmation when my market-makers or proprietary
18 traders bought hundreds of thousands of trades
19 everyday that those trades didn't take place either?

20 And there was no answer. I said, first of
21 all, are you aware of the fact that brokers stopped
22 issuing confirmations years ago?

23 Q. How --

24 A. Because of the clearing corporation.

25 Q. How many years ago?

1 A. Well, there's what's called a continuous net
2 settlement, which I started to say. In other words,
3 when we buy and sell stock all day long, anybody buys
4 and sell stocks when they're long, they don't issue a
5 counterparty confirmation to Merrill Lynch, because
6 those trades are reported automatically through the
7 clearinghouse, and you get -- you don't get
8 confirmations.

9 Customers get -- confirmations get mailed
10 out back and forth, but the industry does not issue
11 confirmations to each other, you know, as a general
12 rule. You can, if you want, but nobody would do that.

13 So I said, so making your supposition that
14 you can't find a confirmation from a brokerage firm on
15 the other side of a customer trade, and you can't
16 find -- you won't find a confirmation on the other
17 side of a - of a non-customer trade either, because
18 they don't -- I don't have any customer confirmations
19 in my records.

20 I said, how can you not understand that?
21 Now, maybe -- like my lawyers -- you can't expect him
22 to understand. They're lawyers. They're not
23 brokerage firms.

24 I said, all right, but you're asking me
25 questions -- you know, they're asking me questions

1 that they have to get somebody that explains that.

2 Now, certainly Dubinsky would know that, but
3 he doesn't even mention -- in fairness to Dubinsky, he
4 doesn't -- he doesn't mention anything about this
5 confirmation issue, because he clearly knows that
6 much.

7 This was the trustee, Irving Picard, and his
8 attorneys, or, I guess, and David's partners or
9 whatever. And maybe they had no reason to know that
10 either, because the average person would not know
11 that.

12 Q. When did the continuous net settlement
13 system come into place? Was it in place in the '80s?

14 A. Yes. Probably in the '80s.

15 Q. Okay.

16 A. So --

17 Q. So how -- how does that work? At the end of
18 the day you just get a computerized printout --

19 A. Right.

20 Q. -- with -- with the net amount that you have
21 to sell --

22 A. Right.

23 Q. -- or receive?

24 A. Right.

25 Q. Okay. Okay. And if you were doing

1 over-the-counter purchases and sales of subordinated
2 bonds, convertible bonds --

3 A. Yeah.

4 Q. -- was that done on a continuous net
5 settlement basis also?

6 A. No.

7 Q. How was that done?

8 A. It was just -- it was -- you wouldn't issue
9 a confirmation. It was -- well, it depends -- you
10 want to know about a convertible bond for a -- for a
11 claim?

12 Q. When you were doing the investment -- I'm
13 focusing on the 1980s.

14 A. Right.

15 Q. The convertible arbitrage transactions.

16 A. Uh-huh. We wouldn't have -- there wouldn't
17 be -- it -- we would issue, you know, a -- we would
18 issue a confirmation there, but we wouldn't have those
19 in our records in the '80s, because we don't hold the
20 confirmations after six years.

21 Q. Right. And the -- if you were -- you were
22 selling to the customer, you had a confirmation, but
23 when you were buying it --

24 A. There wouldn't be a confirmation.

25 Q. -- for inventory, there wouldn't be a

1 confirmation?

2 A. No. Not -- not after six years.

3 Q. Okay. Okay. So we're -- we're going -- we
4 started out listing the mistakes that you felt --

5 A. Right.

6 Q. -- Dubinsky made. Did he make a mistake
7 with respect to using the trade date versus the
8 settlement date; is that what you covered already?

9 A. The average price. Yes.

10 Q. Okay.

11 A. On the ranges?

12 Q. Yeah.

13 A. Well, it's -- if you look at the range on --
14 you wouldn't have -- there wouldn't be a -- there
15 wouldn't be a record of the ranges.

16 Well, first of all, you can't even use the
17 ranges, because you'd have to -- well, he -- in order
18 to -- in order -- in other words, if the SEC was doing
19 an audit, which they did all of the time as to, you
20 know, best -- what's called best execution, they would
21 actually look and see, you know, what dates you bought
22 this stock.

23 Okay. You know, if it was an average price
24 transaction, they would have to go back and look at
25 all of the days, you know, that you accumulated the

1 stock, not just use the last day that you reported the
2 trade to the customer, because they understand what an
3 average price is.

4 Now, the only ones -- typically if you call
5 up a broker, and you tell him, buy me, you know, 50
6 shares of IBM or 200 shares of IBM, they would
7 actually -- they wouldn't do that over the course of a
8 day.

9 All right. Because that -- you know, they
10 would just buy -- it's a small amount of a lot, but if
11 you're dealing with -- with discretionary accounts or
12 you're accumulating a larger -- with a -- a portfolio
13 of accounts, the way we always traded, you would
14 always do an average price transaction.

15 So they -- what they would have to do is go
16 back, which they would do, and see what was your real
17 average price. They would verify what the average
18 price was, not just look at the last day, because they
19 would realize that you would never be able to find
20 a -- you would rarely be able to find a match, because
21 you'd --

22 Q. Right.

23 A. -- have done it, you know, at different
24 periods of time.

25 Q. Right, right. Are there other general

1 mistakes that you can recall from --

2 A. Well, we -- he mentions that David -- well,
3 he talks about David Kugel as -- you know, he mentions
4 in the report that David Kugel -- in other words, he
5 acknowledges that they don't have records going back
6 to the time that David -- he's talking about David
7 Kugel, because we don't -- there are no records.

8 So he's -- he points out as a footnote that
9 he's using David Kugel's information to plea bargain
10 that he created fictitious trades. Now, as I stated
11 before, that makes no sense to me at all.

12 And I think that David Kugel -- I'm not
13 even -- I'm not saying that he's lying. I'm saying
14 that he misinterpreted -- what he said when he created
15 a trade, he's misinterpreting what he's saying.

16 In other words, if -- if -- if I -- if I
17 give instructions to -- you know, if I wanted -- if I
18 decide I want to sell stock to a customer out of my
19 inventory, I -- I could say to someone like David
20 Kugel, you know, I want to sell stock to -- I want to
21 sell, you know, IBM to the client.

22 So we have 100 bonds in -- 100 convertible
23 bonds in the account. I want to sell to Carl Shapiro,
24 you know, 20 bonds. You know, I want to do a
25 convertible trade for him.

1 Give instructions, you know, to Annette to
2 buy, you know, convertible bond, you know, for -- for
3 Carl Shapiro, and, you know, just tell her what --
4 tell them what the formula -- what the formula is, so
5 she knows how many bonds -- how to set the trade up.

6 He -- you know, he would write these
7 instruction sheet -- this -- this convertible bond,
8 you've got to -- if you're going to do 50 bonds, you
9 know, this is -- this is how many bonds, and this is
10 how much stock you sell.

11 And it gives her like -- she then looks at
12 my inventory record and sees, okay. He -- he has X
13 number of bonds he can convert. Takes it out of --
14 out of the investment account or the firm's trading
15 account into this customer account.

16 So David Kugel has no idea, nor has any
17 other trader, what the -- what the firm's net
18 inventory. We could have -- we could have -- we have
19 five different traders trading IBM convert. They're
20 all competing with each other.

21 They don't want to -- they never want David
22 to know what his position is, because he -- you know,
23 they're competing with him. That's part of the
24 strategy of the firm, all market-making firms.

25 So he -- if -- if -- if someone says, well,

1 give them instructions, he'll give -- he'll give
2 Annette or Jodi instructions of how many bonds to --
3 to buy and sell for this customer.

4 He has no idea after that where that --
5 where it's coming from. He doesn't know whether it's
6 coming from the firm's inventory, from his inventory
7 or someone else's inventory. He would not know that.

8 So if -- if he says to somebody, which is a
9 very -- I'm going back to like when I told in my
10 proffer agreement that I short stock to a customer.
11 And they said, you sold stock to a customer? How can
12 you short stock a customer? You're selling them stock
13 that you don't own.

14 And I say, yeah, market-makers do that all
15 day long. That's part of our business. We're
16 shorting stock to a customer. And he -- and an alarm
17 bell goes off and says, well, how can you sell stock
18 to a customer you don't own?

19 Q. Okay. Well, that --

20 A. You know --

21 Q. Let me ask you that.

22 A. Okay.

23 Q. Was that illegal, for you to be selling
24 stock to a customer that you didn't own?

25 A. No. I'll -- I'll -- I'll explain that too,

1 because that's -- that's another issue, but let me
2 just finish this thing.

3 So that if, in fact, David Kugel or anybody
4 is -- is giving instructions to the operations side of
5 the business, meaning Annette or Jodi, of -- of how to
6 do a trade, that doesn't mean that's a fictitious
7 trade.

8 He -- you know, he has no idea. He's just
9 telling her how to do the allocation of the trade.
10 Not -- he doesn't know if -- you know, whether or not
11 the firm has it in inventory or doesn't have it in
12 inventory.

13 But even if I wanted to short it to the
14 customer, let's say I didn't have it in inventory,
15 there's nothing wrong with that. I am allowed to
16 short stock to a customer.

17 Theoretically I could have shorted all of
18 these split-strike trades to the customer forever. My
19 violation was not going short. It was not recording
20 the short on my financial records as a liability,
21 which I guarantee you, nobody understands that.

22 To this day if I called up the prosecutor,
23 Litt, and I said to him, you know, I don't have --
24 there's nothing wrong with me shorting stock. He
25 would look at me and say, that's not true. You can't

1 short to a customer.

2 And I can prove that to you, because I don't
3 know how many times, you know, I had to -- I had to
4 argue this case in front of the SEC and with the
5 issuing companies, like Apple computer and everything
6 at -- when we were at board meetings with the IBM.

7 Average company does not want you to ever
8 short stock. In other words, every company that
9 trades on an exchange does not want a brokerage firm
10 to sell stock that he doesn't own.

11 They think that short selling is illegal, is
12 immoral and should never be done. All right. That's
13 what they want. They don't want ever -- they don't
14 want anybody to be able to short stock.

15 Just like nobody wanted, you know, George
16 Soros to short Sterling and make a billion dollars
17 shorting -- you know, breaking the market on -- on
18 shorting.

19 But what they don't understand is that
20 shorting is a very -- you know, a very, you know,
21 legitimate market, you know, thing to do in the
22 marketplace, and it's required, because it keeps
23 stocks from going to artificially high prices.

24 All right. And the -- it certainly happens
25 that as I was -- when I was looking for -- reading

1 another book, one of the things I do here is I tutor
2 people on finance and the marketplace.

3 Of course, the Bureau of Prisons only big
4 concern is that I'm teaching them a fraud. All right.
5 So originally I was told, no, you can't tutor or teach
6 anybody here, you know, but I said, listen, I said,
7 they -- you have outside people coming in here,
8 professors, to -- to lecture, you know, as part of,
9 you know, the justice department, and they're all
10 asking, can Bernie Madoff -- you have Bernie Madoff
11 sitting here. Let him lecture people.

12 And the Bureau of Prisons says, the
13 newspapers are going to say that Bernie Madoff is --
14 is perpetuating a fraud. Just like when they put me
15 in charge -- when I first got here, my first job was
16 in the engraving department.

17 I was engraving signs, you know, that they
18 hung on walls here. So the -- the Wall Street Journal
19 said, Bernie's first job is engraving, you know. So
20 they said, take him away from the engraving
21 department.

22 And they -- I had seven jobs in seven days,
23 because no matter what I was doing, including I was in
24 charge of cleaning the computers, you know, can't do
25 that, you know, because you're reprogramming the

1 computer.

2 I couldn't reprogram my telephone number.

3 You know, that's not my -- not my strengths here. So

4 I'm now -- my job is now cleaning the laundry room.

5 That's my job here.

6 The -- I'll -- I'll -- there's a book that

7 was written by someone like Dubinsky. He has a very

8 big -- and he talks about --

9 MR. GOLDMAN: Tell us the name of the
10 book and the author, Bernie.

11 THE WITNESS: I don't even know what
12 it --

13 MS. CHAITMAN: May I mark that whole
14 thing as --

15 THE WITNESS: "Secret Weapon."

16 MS. CHAITMAN: -- the next exhibit?

17 MR. SHEEHAN: Could you just mark it as
18 an exhibit?

19 MS. CHAITMAN: Yeah. Let me just mark
20 it.

21 Can I mark this whole thing?

22 THE WITNESS: Yeah.

23 MS. CHAITMAN: Is it all connected?

24 THE WITNESS: Yeah.

25 MS. CHAITMAN: Is it all one --

1 THE WITNESS: Yeah, yeah.

2 MS. CHAITMAN: Okay.

3 THE WITNESS: Anyhow --

4 MS. CHAITMAN: So I'm marking as
5 Exhibit 11 --

6 (MADOFF EXHIBIT 11 WAS MARKED FOR
7 IDENTIFICATION.)

8 BY MS. CHAITMAN:

9 Q. -- a -- it says the author is Kevin Freeman,
10 and the title is, "Secret Weapon." And it's pages --
11 I don't know what the first page is, but the --

12 MR. SHEEHAN: It's the inside cover.

13 Q. The inside cover is 78. 78 to 83, and then
14 123 and 124.

15 A. He's talking about how the markets work. He
16 talks about bear runs, and he talks about naked short
17 selling, and he talks about the Madoff exemption.

18 Q. Is that a term that's in the industry?

19 A. Naked -- yeah, naked --

20 Q. No, but the Madoff exemption?

21 A. Yes. In other words, he goes on to state,
22 "Long before he was convicted of defrauding the
23 American public of some 50 billion through a Ponzi
24 scheme, Bernie Madoff was chairman of the National
25 Association of Securities Dealers, NASD. In that

1 capacity he appeared regularly at the SEC and served
2 on agency panels."

3 And then he quotes them as saying, "When it
4 came to Bernie, people paid more attention, said
5 Georgetown University law school professor, Donald
6 Langevoort, who worked on an SEC panel with Madoff."

7 He quoted -- then goes on to quote, saying,
8 "This was a guy who really knew how markets worked.
9 He was the grownup in the room. If there was a
10 confession" -- "if there was confusion or a question
11 or two people on opposite sides going at each other,
12 Bernie would speak up and explain what the deal was.
13 I'm sure in some ways that may have thrown even the
14 commission off their guard."

15 "One of Madoff's key accomplishments at the
16 SEC was to get a rule approved, the so-called Madoff
17 exemption, that allowed market-makers to naked short
18 sell. Market-makers are broker-dealer firms that gain
19 fees by holding shares of securities in order to help
20 grease the wheels of trading."

21 "If someone buys stock in a company, it is
22 the market-maker who sells the stock and then finds an
23 offsetting order. This keeps the markets flowing
24 smoothly."

25 "In the case of short selling if the

1 market-maker has no inventory of the shares sold, the
2 firm is allowed to create an IOU for the shares. This
3 is a form of naked short selling legalized by the
4 Madoff market exemption."

5 Basically what he's stating, this is the --
6 he's quoting this law professor at Georgetown, who
7 served on a panel with me, that says that I could sell
8 stock short.

9 So selling stock short, not only is it
10 something that is to the benefit of the marketplace,
11 market-makers are required to sell stock short. So
12 theoretically I don't ever have to, you know, buy
13 stock for a customer.

14 I'm responsible for producing that stock if
15 the customer ever wants it. And any profit that the
16 customer makes in the trade I'm responsible for.

17 So in theory, which my attorney said to me,
18 Bernie, you know, you can -- you're not doing anything
19 wrong with being short these split-strike trades to
20 the client, you know. You know, I can short all day
21 long, and I do short stock at times. Every brokerage
22 firm short stocks to a customer.

23 My violation was not showing the IOU, the
24 liability, you know, on my balance sheet. That's what
25 the violation was. I would have also been out of

1 ratio, you know, by not -- if I did show that. So --

2 Q. So you mean that there was -- do you -- if
3 you sell short, do you have an obligation -- is it
4 your understanding that you have an obligation to the
5 customer?

6 A. To produce that stock if the customer wants
7 it.

8 Q. Right, but do you have an obligation -- and
9 we're talking about the investment advisory customer.

10 A. Yes.

11 Q. Did you have an obligation to tell the
12 customer, your statement shows 30 shares of IBM, but
13 I'm actually short that --

14 A. No.

15 Q. -- position?

16 A. No.

17 Q. So it was --

18 A. No. You don't -- you're not --

19 Q. So if -- if a customer is -- if a securities
20 customer is dealing with a market-maker --

21 A. Or anybody.

22 Q. Well, only the market-makers have the
23 exemption.

24 A. No, no. That's -- that's wrong. The
25 market -- the -- the -- anybody can sell stock short

1 to a customer, you know. The -- it's -- they always
2 can sell stock through shorting, but he --

3 You know, what he's talking about is -- you
4 know, is that, you know, I was the one that argued for
5 the short stock selling, because what he -- he
6 confuses the situation, because there are certain
7 requirements that a market -- if a market-maker is
8 shorting stock to a customer or to anybody, he has
9 to -- his records have to show that he shorted the
10 stock.

11 MR. SHEEHAN: Who is, "he"?

12 THE WITNESS: Meaning the brokerage
13 firm.

14 MR. SHEEHAN: Okay.

15 BY MS. CHAITMAN:

16 Q. Okay. So the brokerage -- so let's just
17 take the split-strike. Okay?

18 MR. GOLDMAN: Wait. Before -- before
19 you ask the question, I think he said -- and the
20 transcript will speak for itself, obviously, but
21 I think he said that the -- the market-maker was
22 required to sell short. Did you mean permitted
23 to sell short?

24 THE WITNESS: Well, you -- you're
25 required to make a two-sided market. So if, in

1 fact, you -- you're not required to sell stock to
2 the customer short. You're allowed to sell stock
3 to a customer short.

4 MR. GOLDMAN: That's --

5 THE WITNESS: If -- in other words,
6 that's the difference. You have to be -- you
7 have to sell it at a price that's related to the
8 marketplace, you know.

9 And you have to -- you -- you -- you
10 would put it on your records that you're selling
11 short on the original order ticket. You have to
12 mark it, because it's what they call an uptake
13 rule and so on, which means you have to -- it's
14 not important. It's confusing.

15 BY MS. CHAITMAN:

16 Q. Okay. So -- so basically if you take John
17 Smith. He's a split-strike customer. His statement
18 shows that he owns a portfolio of securities, and, in
19 fact, you don't at that time own them.

20 A. No.

21 Q. Are you saying that there's nothing
22 fraudulent about issuing a statement to an IA
23 customer --

24 A. Uh-huh.

25 Q. -- an investment advisory customer, showing

1 securities as having been purchased for the customer,
2 when, in fact, they haven't been purchased?

3 A. That's correct.

4 MR. SHEEHAN: Object.

5 THE WITNESS: You don't have to --
6 you're not required. It's not the customer's
7 business whether or not you're selling the stock
8 from long or whether you're selling it short.

9 BY MS. CHAITMAN:

10 Q. Okay. So what you're saying is that the
11 fact that the split-strike conversion strategy was
12 carried out from sometime in 1992 until December of
13 2008 without your actually owning the securities that
14 showed up on the statements, that was not a fraud, but
15 the fraud was that you didn't disclose to the SEC on
16 your focus reports --

17 A. That's correct.

18 Q. -- that you had that debt?

19 A. Right.

20 MR. SHEEHAN: Objection. Objection,
21 but go ahead.

22 THE WITNESS: That's correct.

23 BY MS. CHAITMAN:

24 Q. Okay. Can you put this in your own words,
25 so we don't have any confusion about it? I just want

1 it to be very clear on the record.

2 A. That there is nothing wrong with selling
3 stock to a customer out of a short position. In other
4 words, you do not have -- that is not a violation.
5 The violation -- and it is typical for a brokerage
6 firm to at times sell stock to a customer short. That
7 is not a violation itself.

8 And the customer doesn't care whether the
9 stock that you are selling him is stock that you
10 actually are long or short. You know, the customer
11 assumes, as -- and, rightfully so, that if he wants --
12 if wants delivery of those securities, or he wants the
13 profit made from the transaction, that you're still
14 obligated to do that.

15 So had I reported this transaction on my
16 financial records as a liability, that would be --
17 that would be all right, but because I didn't, that's
18 where the violation was.

19 Now, obviously, I couldn't do that, because
20 my -- my liabilities would have been too great. Which
21 brings me to another error, you know, that I find in
22 the Dubinsky report. See if I can remember where it
23 was. Related to that. The -- well --

24 Q. Do you -- do you want -- do you want her to
25 read back your last comment? Maybe it'll prompt you

1 to --

2 A. No.

3 Q. -- to recall.

4 A. No. I'll think of it. First of all, here
5 is this. This is yours, and this is yours, I think.
6 I have too much paperwork here.

7 Q. I just want to go back -- back to this.
8 Forgive me, but it intrigues me.

9 So the entire portfolio that was purportedly
10 owned by the investment advisory customers from 19 --
11 from whenever it was in 1992 that you stopped buying
12 the securities that showed up on the statements until
13 2008, you had always honored withdrawals?

14 A. Right.

15 Q. You never defaulted in any of your
16 obligations to the customers?

17 A. Not until, you know, I went out of business.

18 Q. Right. Okay. So the only violation of law
19 that you understand you committed was not disclosing
20 on your focus reports that you had sold short; is that
21 right?

22 A. Not that I had sold short. That I didn't --
23 I did not reflect my liabilities. That was because of
24 the short position.

25 Q. Right.

1 A. The short position would have reflected a
2 liability to the customer.

3 Q. To purchase the shares?

4 A. I did not show that.

5 Q. Okay. Okay. And I just want to ask you one
6 other thing, which is not related, except it came into
7 my mind.

8 A. Okay. Before you do that --

9 Q. Oh, okay.

10 A. -- I remembered what I was going to say.

11 Q. Go ahead.

12 A. Dubinsky states that -- well, he -- he -- he
13 acknowledges that he -- he doesn't have records to
14 prove this, but he infers in some language that
15 because I did not on my focus reports --

16 One of the -- one of the things that he --
17 points he makes to demonstrate that I was -- he was
18 trying to establish his theory, obviously, initiated
19 by the trustee, that my fraud went back almost to the
20 beginning of time.

21 All right. That I didn't do any business,
22 because I did not reflect any customer business on my
23 financials -- on my focus reports. Customers that
24 were -- you know, activity, long and shorts.

25 So -- because he says that, you know, I

1 mean, he -- he's saying he could have been doing
2 business in -- for customers in the '80s or '70s or
3 '60s, the '70s even, because my focus reports, which
4 he doesn't have, by the way, because he doesn't -- he
5 can't get that, but he's assuming that there was no
6 customer, you know, business -- no customer positions
7 shown on my focus reports.

8 All right. But this is a common error made
9 in -- by customers in general. I used to get calls
10 from people that would say, listen, Merrill Lynch
11 doesn't show, you know, my assets on a position.

12 He's doing all of this business with -- with
13 me or with all of these customers, and it doesn't show
14 on Merrill Lynch's financial statements, you know, any
15 of this business.

16 I said, well, are you talking about his
17 balance sheet? He says, yeah. I said, brokerage
18 firms do not show customer assets fully paid for
19 securities on their balance sheets. Otherwise,
20 Merrill Lynch would have trillions and trillions of
21 dollars.

22 I said, you know, when a brokerage firm
23 files a focus report or any balance sheet, when they
24 send you, you know, they do not -- they do not show or
25 record customers' fully paid for securities.

1 So if a customer had a margin account or
2 a -- you know, a liability, he would have to show a
3 payable or a receivable from a customer.

4 But if a customer buys IBM, pays for the
5 IBM, and the brokerage firm has that IBM in his -- you
6 know, in his box or at the clearing corporation, that
7 doesn't appear on his records anywhere. So, you know,
8 as long -- if I was -- if I had a -- a liability, and
9 not from a short sale, because, you know, the short
10 sale -- the short sale, if it's a liability, would
11 appear on it, but if he was long and short, the
12 same -- it's another thing.

13 When you're trading in convertible
14 securities, you're -- you're allowed to net the -- the
15 receivable and payable for the same customer against
16 each other. So that stuff does not appear on a focus
17 report.

18 Now, that's a basic accounting. Anybody
19 that's a -- anybody that's familiar with any brokerage
20 firm accounting would know that question. So why he
21 would think there would be a -- that would be on my --
22 on my balance sheet, it's not certain.

23 What would be on my balance sheet would be
24 if the customer owed me money, which is another thing.
25 There's a -- there's a major flaw. And this I have to

1 address, even though you didn't ask me about it.

2 The trustee somehow or other when I read the
3 GAO report -- and I actually spoke to the treasury
4 secretary -- the inspector general of the treasury
5 department about this.

6 In the -- in the -- in the GAO report,
7 issued by the government, which is a report that he
8 issues from the general accounting -- accountability
9 office, based upon the trustee's report, there's a --

10 I have a -- this is something that -- David,
11 you might ask Irving Picard how he had managed to get
12 this thing slipped through.

13 Jeffry Picower --

14 MR. GOLDMAN: Tell us what you're
15 looking at, Bernie.

16 THE WITNESS: Oh, this is the GA -- a
17 copy -- part of the G -- the SIPC report, the GAO
18 report, which is -- took seven years to -- to
19 finally get, which my attorneys assured me was
20 going to be done immediately. It took seven
21 years to finally get them to do the results of --
22 of the trustee's report.

23 There's a 6.3 billion dollar liability
24 to the debit balance in Jeffrey Picower's
25 account, which was a -- a major issue was one of

1 the things that created my whole problem. This
2 relates to them -- them not honoring their
3 commitments with me when -- and --

4 Okay. This is on -- and I can't give
5 you -- this is my only copy, but you can find it.
6 It's on page 37 of the -- of the GAO report.

7 And I'm quoting now the General
8 Account -- Accounting Office. It says, "As part
9 of our review of the records provided by the
10 trustee, we noted some customer accounts having a
11 negative balance."

12 "For example, in the Picower case the
13 records showed a negative balance of 6.3 billion
14 dollars. In theory this reflected some kind of
15 margin account or debit balance."

16 "The trustee told us even though such
17 an account would not be in keeping with the
18 standard industry practice, such negative
19 balances raised the question of whether the
20 reported amounts represent a debt owed by the
21 customers to the Madoff firm."

22 Now, that clearly is a debt. All
23 right. Jeffry Picower owed me 6.3 billion
24 dollars. All right. The trustee -- I mean, the
25 GAO -- thank God. He questioned the trustee,

1 what about the 6.3 billion dollars?

2 And for some reason the trustee
3 claimed, well, we can ignore that, you know.
4 That's not typical.

5 All right. Now, if you look at my
6 records or any brokerage firm's records or
7 account agreements with customers, it clearly
8 states that, you know, they're responsible for
9 any debit balances or margin accounts that they
10 have with the firm.

11 It says here on my trading
12 authorization, which clients sign, it says, "The
13 undersigned hereby agrees to indemnify and hold
14 you harmless from and to pay you promptly on
15 demand any and all losses arising thereof or
16 debit balance due hereon."

17 In other words, every customer that
18 opens a margin account or has any debt with a
19 brokerage firm owes them that money. All right.

20 MS. CHAITMAN: Okay. Can I just
21 mark -- okay. I'm going to mark as Exhibit 12 --
22 can I take that? Is that one document, the one
23 you just read from?

24 THE WITNESS: Yeah.

25 MS. CHAITMAN: Okay. So I'm marking as

1 Exhibit 12 -- this is a trading authorization.

2 THE WITNESS: Here, what -- use this
3 one, because this one is -- this copy is better.
4 It's the same type of thing.

5 MS. CHAITMAN: Okay. So I'm -- you
6 know what? Can I mark them both? Because you
7 read this one. So --

8 THE WITNESS: It's the same -- it says
9 the same thing.

10 MS. CHAITMAN: Okay. All right. So
11 I'm marking as Exhibit 12 the one you read.

12 (MADOFF EXHIBIT 12 WAS MARKED FOR
13 IDENTIFICATION.)

14 MS. CHAITMAN: And I'm going to mark as
15 Exhibit 13 something called, "Trading
16 authorization limited to purchases and sales."

17 (MADOFF EXHIBIT 13 WAS MARKED FOR
18 IDENTIFICATION.)

19 BY MS. CHAITMAN:

20 Q. And can you just read in whatever the
21 language is that you want?

22 A. Uh-huh. All right. So for some reason, you
23 know, the trustee convinced the GAO -- I don't --
24 maybe they didn't care that much about it -- that this
25 six -- that this debit balance was not typical at a

1 brokerage firm or that they weren't. Now --

2 Q. Wait. I just want to go back to this. I
3 don't want to lose track of it.

4 MR. SHEEHAN: Sure.

5 BY MS. CHAITMAN:

6 Q. You -- you said that this has better
7 language on the points.

8 A. It doesn't -- it just shows the customer --
9 every customer agreement always has that customers are
10 responsible for any debit balance --

11 Q. Okay.

12 A. -- they owe the brokerage firm.

13 Q. Okay. Okay.

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19 Q. Okay.

20 A. All right.

21 Q. So I want to go back to one other question.

22 When you stopped buying securities on the split-strike
23 customer accounts, and you said you did that for a
24 short period of time, and then you stopped.

25 A. It wasn't a short period of time. It was

1 from 1992 to 2008.

2 Q. Right, but I understood your testimony to be
3 that when you initiated that program you actually were
4 buying.

5 A. Oh.

6 Q. Am I correct about that?

7 A. Yes, but that was prior to that. That was
8 before the hedge funds. That was prior to '92.

9 Q. Oh, okay. Okay. Okay. I'm glad you
10 clarified that.

11 So what -- what were you doing with the
12 money? Let's say that Customer A sent you a million
13 dollars for the split-strike program.

14 A. It went into --

15 Q. What --

16 A. -- treasury bills.

17 Q. It went into U.S. treasury bills?

18 A. Well, some of it went into treasury bills.
19 Some of it went back to customers when they withdrew
20 profits --

21 Q. Okay.

22 A. -- that didn't exist.

23 Q. The -- the portion that went into treasury
24 bills, were those interest-paying treasury bills?

25 A. Yeah.

1 Q. And do you remember in 1992 what the
2 interest rate was -- was on the treasury bills?

3 A. Probably like two percent, something like
4 that, on -- you know, one and a half, two percent.

5 Q. Okay. And is it fair to say that for the
6 whole period up until 2008 that the money that wasn't
7 used to redeem customer accounts was in treasury
8 bills?

9 A. Probably, yeah.

10 Q. And that would have been interest-earning
11 treasury bills?

12 A. Yeah.

13 Q. Whatever the current interest rate was; is
14 that right?

15 A. Uh-huh, uh-huh.

16 Q. Were these longer-term treasury bills --

17 A. No.

18 Q. -- or shorter term?

19 A. No. They were short term. They were
20 T-bills, you know. You know, the short term. One to
21 two years.

22 Q. Okay. So the customers' money was earning
23 some percentage?

24 A. Yeah.

25 Q. Whatever the treasury bill rate was?

1 A. Yeah, but there wasn't enough treasury bills
2 to cover all of the liabilities.

3 MS. CHAITMAN: Okay. Does everybody --
4 do you want to take a break, and then we'll go
5 through until --

6 MR. SHEEHAN: Sure. As a --

7 MS. CHAITMAN: Because I'm about to --
8 to go through the Dubinsky report, which is going
9 to be tedious. Why don't we take --

10 MR. SHEEHAN: Whatever.

11 MS. CHAITMAN: -- five minutes.

12 MR. SHEEHAN: Five minutes?

13 MS. CHAITMAN: Yeah.

14 MR. SHEEHAN: That's good.

15 THE VIDEOGRAPHER: Going off the
16 record. The time is 13:01.

17 (RECESS FROM 1:01 P.M. TO 1:18 P.M.)

18 (MADOFF EXHIBIT 14 WAS MARKED FOR
19 IDENTIFICATION.)

20 THE VIDEOGRAPHER: Back on the record.
21 This begins media number three in the deposition
22 of Bernard L. Madoff. The time is 13:18.

23 BY MS. CHAITMAN:

24 Q. Mr. Madoff, I've just given you what had
25 previously been marked in your -- in a -- your

1 deposition in June, but I've renumbered it as Madoff
2 Exhibit 14.

3 This is a statement for one of my clients,
4 Arthur Blecker. It's dated June 30th, 1986. And what
5 is the trading strategy on this statement?

6 A. It looks like a convertible bond, buying
7 convertible bonds and selling the -- the related
8 stock.

9 Q. Okay. And where it says long --

10 A. Uh-huh.

11 Q. On this statement, which was sent to the
12 customer, long means that the customer owns it; right?

13 A. Correct.

14 Q. Whereas, on the confirmation, the actual
15 trade confirmation, it would be the opposite; right?
16 It would show --

17 A. That -- that Madoff sold it to the customer.
18 "We sold," it would say.

19 Q. It would say the firm --

20 A. The firm sold it to the customer.

21 Q. -- sold to the customer.

22 Okay. And, conversely, where it says,
23 "Short, Interco, Inc." --

24 A. It would show we bought from the customer.

25 Q. Okay. And am I correct that your testimony

1 is that all of the long positions reflected on the
2 arbitrage strategy statements were actual positions
3 that you held?

4 A. That's correct.

5 Q. Okay. So, if you can, I want you to take a
6 look in the Dubinsky report, which we've marked as
7 Exhibit --

8 MS. CHAITMAN: What did we mark it as?

9 MS. FEIN: 7.

10 MS. CHAITMAN: Dubinsky --

11 MS. FEIN: 7.

12 MR. SHEEHAN: 7.

13 BY MS. CHAITMAN:

14 Q. 7. As Exhibit 7. If you could, look at
15 page 16.

16 A. Okay.

17 Q. In paragraph 35, this is the beginning of
18 Dubinsky's factual background, and it says, "BLMIS."
19 "In 1960 Madoff founded BLMIS as a sole
20 proprietorship. BLMIS" --

21 MS. CHAITMAN: Page 16.

22 MR. GOLDMAN: Okay.

23 BY MS. CHAITMAN:

24 Q. -- "a market-making business in
25 over-the-counter stocks was registered as a

1 broker-dealer with the Securities and Exchange
2 Commission as of January 19th, 1960 and operated three
3 business units."

4 "One, a market-making business, two, a
5 proprietary trading business, and then," parentheses,
6 "together with the market-making business, known
7 inside BLMIS as House Five," end paren, "and, three,
8 an investment advisory business," paren, "known inside
9 BLMIS as House 17."

10 A. Right.

11 Q. Now, did people at your firm use the phrase
12 House 17?

13 A. In the firm?

14 Q. Yes.

15 A. Yes.

16 Q. And during what period of time? From 1960
17 on?

18 A. No. Because the 17th floor wasn't in
19 existence in 1960. It only came into existence, you
20 know, in the '80s. It was -- House 17 just refers
21 to -- that was the business that operated out of the
22 17th floor.

23 Q. Okay. But -- and that was the business that
24 was --

25 A. The IA business. It was basically just

1 split-strike business, because that was -- that did --
2 I think the 17th floor came into existence after 19 --
3 in -- after '92.

4 Q. Right. So isn't -- isn't it a fact that
5 when you -- when you started doing the -- we'll call
6 it, the fraudulent investment advisory business, that
7 you moved the people who did that down to a separate
8 floor?

9 A. That's correct.

10 Q. And was your idea to separate them from
11 everyone else, so that there wouldn't be --

12 A. Well, what happened was when we closed the
13 Avellino & Bienes' accounts in '92, the -- when we --
14 when -- I decided to take the -- those clients back
15 directly into the account.

16 So the -- in other words, after I -- I
17 returned the money to Avellino & Bienes' accounts,
18 there was an uproar from those accounts, as well as my
19 father-in-law, because they were all basically -- most
20 of them were -- were his accounting clients, and
21 they -- you know, they all wanted to continue to do
22 business.

23 The SEC had told me at the time, they said,
24 look, you -- you want to -- you want to still do
25 business with these people. That's fine, because

1 there's nothing wrong with you doing business with
2 these people.

3 As a matter of fact, they said, if you want
4 to do business with the Avellino & Bienes' people,
5 that's -- that's fine too. They just have to register
6 as an -- as a registered investment company, you know.

7 I said, no. I said, I'm -- I was furious
8 with -- with them at the time, because they had never
9 told me that they had changed their mode of operation,
10 where they were now paying them, you know, interest
11 on -- on a loan.

12 That was not something that was ever agreed
13 upon with me. So I said, I'm -- you know, I decided
14 I'm sending the money back, closing those accounts,
15 but, of course, I started getting, you know, a lot of
16 pressure from these people, who were relying upon that
17 money, you know, to live on, you know.

18 They said, no. Why -- why can't we open a
19 direct account with you, you know? I said, well,
20 because I'm not really equipped to handle all of these
21 individual accounts, you know. I -- they had like 500
22 customers, you know, clients, you know.

23 So I said, look, you know, I don't want to
24 do that. But then it was Frank DiPascali basically
25 who said -- because he was, you know, handling that

1 stuff at the time. He said to me, look, let's -- you
2 know, let's take these -- these new clients.

3 And I said, well, you know, it's like, you
4 know -- it's -- who the hell is going to handle all of
5 that stuff? And he was the one that said, well, you
6 know, we'll just computerize the trading, and, you
7 know, I -- I can handle all of that stuff.

8 So I operated -- I said, all right. You
9 want to start doing that, we'll -- we'll start doing
10 that. And that's when I -- I needed more space and
11 operated and put them on the 17th floor.

12 Q. Okay. So House 17 was only a term used
13 after 1992?

14 A. Pretty much. It's -- to my recollection,
15 yes.

16 Q. Okay.

17 A. Because it didn't exist, the 17th floor --

18 Q. Okay.

19 A. -- before then.

20 Q. Okay. And is it fair to say that it was
21 only after House 17 was formed, by that is you moved
22 people downstairs, that it was only after that that
23 you first began the investment advisory fraud?

24 A. Correct.

25 MR. SHEEHAN: Objection. Go ahead.

1 BY MS. CHAITMAN:

2 Q. Let me ask that in a way that Mr. Sheehan
3 won't object.

4 Was there any investment advisory fraud done
5 by your firm prior to the formation of House 17?

6 A. No. I mean, I'm not exactly sure how you're
7 using House 17, like in what reference, you know.

8 Q. Well, the -- when you moved people down to
9 the 17th floor --

10 A. Uh-huh.

11 Q. -- it was Frank DiPascali, Jodi Crupi,
12 Annette Bongiorno?

13 A. Yes. And then the -- the whole -- the
14 mailroom was down there and the -- you know, part of
15 the computer operation was down there. Anything
16 that -- anybody that was going to be related to all of
17 these accounts basically.

18 Q. Okay. And -- but that was -- that was done
19 sometime in 1992 --

20 A. Right.

21 Q. -- or '93?

22 Well, do you remember when?

23 A. No. I don't remember. It was like -- I --
24 you know, I'd have to look at the leases, but
25 basically it was -- it all started basically after

1 the -- I know it was '92, because that was when the
2 Avellino & Bienes thing blew up.

3 Q. Okay. Okay.

4 A. It was the summer of '92, was when the
5 Avellino & Bienes started. So it would have to be
6 sometime after that.

7 Q. Okay. Now, during the period prior to 1992
8 was the investment advisory operation handled
9 separately from the market-making and proprietary
10 trading?

11 A. Yes. Yeah, it always was.

12 Q. It was always handled separately?

13 A. (WITNESS NODS HEAD UP AND DOWN.)

14 Q. But --

15 MR. SHEEHAN: The witness nodded yes.

16 THE WITNESS: Huh?

17 MR. SHEEHAN: You nodded yes.

18 MR. GOLDMAN: You have to verbalize
19 your answer.

20 THE WITNESS: Oh.

21 MR. GOLDMAN: You seemed to indicate
22 while you're nodding your head.

23 THE WITNESS: Yes.

24 MR. SHEEHAN: Thank you.

25 BY MS. CHAITMAN:

1 Q. During the 1980s who was responsible for the
2 investment advisory accounts, like we just looked at
3 the -- the Blecker statement, June 30th?

4 A. Me.

5 Q. You handled that?

6 A. Right.

7 Q. Okay. Did you have traders who were in the
8 market-making or proprietary trading groups that
9 actually did the trading for the investment advisory
10 customers in the '80s?

11 A. No. The only one that handled the -- that
12 spoke to the clients and that made the decision of
13 what to buy and sell for the clients was myself.

14 Q. Okay.

15 A. Not -- none of the market-makers. I mean,
16 market-makers might have bought stock into the
17 firm's -- into the firm's inventory, but I was the one
18 that actually made the decision as to put the -- put
19 the trade through to a client account.

20 Q. Okay. And since you were buying from
21 inventory, you could just look at the inventory and
22 decide what --

23 A. Yeah.

24 Q. -- to sell to the --

25 A. Or if I went out and -- you know, or if it

1 went -- or if the market-maker bought it from the
2 street into -- into his account, and then I would make
3 the decision --

4 Q. Okay.

5 A. -- to put it into a client account.

6 Q. Okay. If you'd be good enough to look at
7 paragraph 119 of Dubinsky's report.

8 MR. GOLDMAN: One -- one --

9 MS. CHAITMAN: It's paragraph 119.

10 MR. SHEEHAN: Paragraph 119. Okay.

11 THE WITNESS: Where the hell is
12 paragraph 119?

13 MS. CHAITMAN: The --

14 MR. GOLDMAN: Page 51.

15 THE WITNESS: What page?

16 MR. GOLDMAN: 51.

17 THE WITNESS: Okay. Uh-huh.

18 BY MS. CHAITMAN:

19 Q. If you could, just read paragraphs 185
20 through 190. I just want to ask you some questions
21 about --

22 A. Paragraph one --

23 Q. 185.

24 MR. SHEEHAN: Okay. So we're --

25 MS. CHAITMAN: You know what? Oh,

1 we're looking at different --

2 THE WITNESS: I'm not with you.

3 MS. CHAITMAN: You know what? I've got
4 different versions of the Dubinsky report.
5 Let -- let me do it differently. Hold on one
6 second.

7 BY MS. CHAITMAN:

8 Q. Okay. If you'd be good enough to turn to
9 page 35. So Mr. Dubinsky's -- the heading on
10 subparagraph two is that, "Purported convertible
11 security trades exceeded the entire reported market
12 volume for certain days."

13 A. Uh-huh.

14 Q. Do you see that heading?

15 A. Right.

16 Q. Okay. And then he explains that he looked
17 at reported records on the New York Stock Exchange,
18 the daily stock price record, the --

19 A. Uh-huh.

20 Q. -- American Stock Exchange and the daily
21 price record from the New York Stock Exchange; do you
22 see that?

23 A. Right.

24 Q. And he reached the conclusion that these had
25 to be fraudulent trades, because there weren't that

1 many trades done on those days?

2 A. Right.

3 Q. And I believe you've already explained, but
4 can you just explain again why this conclusion is not
5 correct?

6 A. Well, he's -- he's making -- he's
7 referencing in his footnote that the data was
8 collected from the daily stock price record from the
9 New York Stock Exchange, from the daily stock record
10 price and the American Stock Exchange, which provided
11 the month and short position of the data.

12 These trades were not executed. There's no
13 relevance to looking at the New York Stock Exchange or
14 the American Stock Exchange, because they wouldn't
15 be -- stock would never have been transacted on
16 those -- on those exchanges anyhow.

17 Q. Okay. And is that a fact that's generally
18 known or -- I mean --

19 A. Well --

20 Q. If you --

21 MR. SHEEHAN: Object to the form.

22 THE WITNESS: Anybody that knew
23 Madoff's business -- I mean, anybody, including
24 the clients, it would be hard -- I mean, we were
25 relatively famous for, you know, trading off the

1 floor of the exchanges.

2 So, I mean, with -- anybody that was a
3 client of ours or that was a regulator or that
4 was in the industry would know that our business
5 was not transacted on the floor of the New York
6 Stock Exchange.

7 BY MS. CHAITMAN:

8 Q. Okay. Now, looking at page 36.

9 A. Uh-huh.

10 Q. Dubinsky has a chart showing that most of
11 the trades that -- you know, 41 percent, there were no
12 trades occurred in the market that -- that exceeded
13 one to two times the number of trades on the account
14 statements.

15 Is that again because he's not looking at
16 the right place, he doesn't have the records to show
17 the trades?

18 MR. SHEEHAN: Object.

19 THE WITNESS: Yes.

20 BY MS. CHAITMAN:

21 Q. Okay. Now, on page 37 Mr. Dubinsky is
22 saying that the transactions reported on the
23 Avellino & Bienes' statements were -- were not
24 possible because of the volume in the market.

25 Did you make up the trades for the

1 Avellino & Bienes' clients, or were those actual
2 trades?

3 A. You talk -- what period of time are you
4 talking about?

5 Q. Well, the Avellino & Bienes' clients during
6 the 1980s on the convertible --

7 A. Right.

8 Q. -- arbitrage, were those actual trades or
9 were those made-up trades?

10 A. Those were actual trades.

11 Q. Okay. If you look on page 38.

12 A. Uh-huh. All right.

13 Q. Mr. Dubinsky opines that the -- the purchase
14 prices of the convertible securities did not represent
15 market prices?

16 A. Right.

17 Q. I think you've spoken to this, but can you
18 just briefly summarize your position on this.

19 A. He's -- he -- he's -- he's referencing the
20 New York Stock Exchange bonds, and none of these
21 trades would have -- you know, were executed on the
22 New York Stock Exchange.

23 Q. Okay. Would it be possible for someone to
24 actually check the prices? Are there records that
25 exist or that even existed as of 2008 which would have

1 shown what the trade prices were on the
2 over-the-counter market in the 1980s?

3 A. Would there be --

4 Q. Is there anyplace that one could have looked
5 for that?

6 A. On a -- if it was a convertible bond?

7 Q. Yes.

8 A. Probably not, because -- well, certainly you
9 wouldn't reference the New York Stock Exchange. The
10 trade didn't take place on that. As to -- there
11 were --

12 It depends upon -- I'm not sure when -- when
13 there was any records kept as to over-the-counter bond
14 transactions. That was always sort of a sketchy area.

15 There was confusion in the industry whether
16 bonds that trades -- the bonds that were traded over
17 the counter were reported or not reported. The -- I'm
18 not sure about what date that was.

19 And, then again, it depended upon how they
20 were reported, because if the bonds were done after
21 hours, they wouldn't be reported to any facility.

22 Sometimes you would have to call up the --
23 for awhile the NASD put a system in where you would
24 call them up and report them over the phone, you know,
25 after the close of the day, but there was always sort

1 of confusion about that.

2 Q. Did the trustee or any attorney working for
3 the trustee ever ask you whether you purchased the
4 convertible bonds --

5 A. Not to my recollection.

6 Q. -- through the New York Stock Exchange?

7 A. No.

8 Q. Did they ever ask you anything about how you
9 acquired the bonds?

10 A. I don't think so.

11 Q. Did they ever talk to you about how the
12 bonds were priced?

13 A. No.

14 Q. Now, on page 40 Mr. Dubinsky states at the
15 top of the page that, "Convertible securities were
16 purportedly traded by the IA business even after they
17 were called for conversion."

18 A. Correct.

19 Q. Do you have any comment on that conclusion?

20 A. No, because, you know, I don't -- I don't
21 remember this particular trade. You know, I wouldn't
22 have -- it was so long ago that I wouldn't have
23 record.

24 And, again, I'm not sure that you -- I'm not
25 sure of whether or not you are able to trade a bond

1 after the fact that it was converted, called for
2 conversion. I mean, you weren't forced to convert, to
3 my knowledge.

4 Q. Okay. Well, he only gives one example, and
5 it's McMillan. And he writes in paragraph 100, "The
6 IA business purportedly closed out its position on
7 March 14th, 1985. However, this" -- "the subordinated
8 debentures were converted into 1.6 million shares of
9 common stock in January 1985."

10 A. He said it was -- it was -- it was -- what?
11 It was converted -- it was --

12 Q. Look at paragraph 100.

13 A. Uh-huh. Is he saying they were called or
14 converted?

15 Q. He's saying that the subordinated debentures
16 were converted.

17 A. Oh, he's saying called, I think. He said
18 they were -- they were called. Right. He -- he --
19 what he's pointing out to is these bonds were -- were
20 called, but it was closed out on the customer account
21 in March.

22 Now, that, to me, looks like that this bond
23 was -- was -- was unwound or swapped, and it may have
24 not been closed out. And the customer -- looking at
25 the customer account, it just says, "Received and

1 delivered."

2 It doesn't say converted, which -- which is
3 the way it would always appear, because when we
4 were -- it means that we were unwinding the customer
5 position from -- into the firm's trading account. It
6 was an internalized trade.

7 So, as far as -- you know, they may have
8 called the bonds, you know, then, but he was -- but he
9 was basically pointing out that we would have had to
10 physically convert it, you know, transfers, if, in
11 fact -- you know, obviously, you couldn't physically
12 convert it after the bond was called, because --

13 Q. Right.

14 A. -- they wouldn't do that.

15 Q. Right.

16 A. So that -- that points out to me that that
17 was a trade that was unwound internally. That we were
18 just closing out the trade and the customer account
19 transaction.

20 Q. Okay.

21 A. It wasn't a bond that was issued to me. You
22 know, it wasn't -- wasn't turned into the company
23 itself.

24 Q. Okay.

25 A. Like a conversion.

1 Q. Okay. In the heading above paragraph 101,
2 he wrote, "The IA business did not account for
3 dividend payments or accrued interest on the
4 convertible securities."

5 A. Uh-huh.

6 Q. "Thereby evidencing the fictitious" --
7 "fictitious nature of the underlying transactions."

8 A. It depends upon whether the bond -- you
9 know, there are instances where a bond is -- is
10 bought, you know, what they call traded flat. It
11 means traded without -- without interest.

12 It's like that with dividends also. You can
13 trade a stock flat X dividend. You buy it at a lower
14 price, because you're buying it without the dividend.

15 It's -- it's a transaction that you would --
16 you know, typically it would be done between dealers
17 and professionals, not for the average customer,
18 because these -- these instruments are bought to
19 trade.

20 They're not interested -- they're not bought
21 as an investment purpose to be held, which is the
22 way -- you know, which is -- if you were doing that as
23 typically an investment type of account, then,
24 obviously, you would want to, you know, get the
25 dividend for income and so on and so forth.

1 But professionals will trade what they call
2 flat -- or just like you could buy a zero coupon bond.
3 Most customers don't buy zero coupon bonds, but -- but
4 dealers, traders, like ourselves, typically will
5 trade, you know -- you know, zero coupon bonds are
6 flat, because what you're really doing is you're
7 not --

8 The idea of the trade is not to cash the
9 dividend or the interest, but basically to use the
10 instrument as a trading vehicle, but you -- when you
11 do that, obviously, you account for the dividend in
12 the price of the stock.

13 So you're -- you adjust the price of the
14 stock to the client based upon the fact that you're
15 not getting a dividend.

16 Q. So --

17 A. And, also, one of the things Dubinsky
18 doesn't seem to account for is that brokerage firms
19 trade what they call due bills.

20 In other words, most -- when you buy stock
21 frequently, you're not getting the -- the dividend
22 from the company, because you're buying the stock --
23 it's coming -- it's being transacted in what's known
24 as street name, which is -- it's not in -- registered
25 in -- in the client's name and so on.

1 So you -- a lot of times -- very frequently
2 you'll buy stock from a customer that pays a dividend
3 or declared a dividend, and you won't get the
4 dividend. The company is going to pay the dividend to
5 whoever the stock's name is registered in.

6 And most stocks are not registered in
7 clients' names anymore. They're -- they're registered
8 in a street name. So the brokerage firms will issue
9 due bills to each other to get the monies, and then
10 you just journal it into a client account.

11 He doesn't go into any of that, which is --
12 I can understand, you know. I'm not faulting him for
13 that. It's not that the customer didn't -- didn't get
14 the price.

15 So our customer -- if they weren't getting
16 the dividend, they were -- they were getting a lower
17 price on the stock, you know, to account for that,
18 because the firm is going to get the dividend.

19 So you have to make the customer whole some
20 way. When you're internalizing trades as principal,
21 that's a common way of doing business.

22 Q. Did Mr. Dubinsky ever talk to you?

23 A. No. I never knew he existed until I saw the
24 report.

25 Q. Okay. Did anyone from the trustee's side,

1 any expert, ever question you about any of the --

2 A. To my recollection --

3 Q. Let me just finish the question.

4 -- any of the convertible arbitrage trade?

5 A. No. I never had any conversation with the
6 trustees regarding any of this trading, other than
7 when they came down here to speak to me, but I don't
8 think they ever really got into -- into the trading.

9 Q. Okay. Mr. Dubinsky reaches the conclusion
10 on page 41, just above paragraph 105, that there's no
11 evidence that the IA business converted the
12 convertible securities into common shares; do you see
13 that?

14 A. Yeah.

15 Q. And then he says, "Companies that have
16 publicly-traded securities typically use third-party
17 institutions, known as transfer agents, to keep track
18 of the individuals and entities that own their stocks
19 and bonds."

20 "Most transfer agents are banks or trust
21 companies. Although, companies sometimes act as its
22 own transfer agent. The transfer agent maintains
23 records of the shareholder information."

24 And then in paragraph 109, he says, "In
25 order to have converted preferred convertible stock

1 and convertible debt into common stock, the IA
2 business would have needed documentation regarding the
3 conversion of the securities."

4 A. Uh-huh.

5 Q. Now, did you have that documentation, or did
6 you --

7 A. No. As I stated earlier, if -- if we
8 converted -- when we converted stock, we typically
9 would have one of our clearing facilities convert the
10 stock.

11 Meaning, Commercial Bank of North America,
12 Bankers Trust, Irving, any one of those people.
13 Marine Midland that -- that provided that facility for
14 us.

15 So we would not, except under rare
16 occasions, physically convert the stock ourselves.
17 Doesn't mean the stock wasn't converted.

18 Q. Okay.

19 A. And, as far as him relating to the transfer
20 agents, the stock trades in street name. So --
21 meaning it's -- it's traded as a negotiable
22 instrument. It's not -- it's very rarely put in a
23 customer's name, unless the customer is going to
24 request delivery of the securities.

25 So if a customer wants to hold the

1 securities themselves, which now doesn't exist -- as a
2 matter of fact, they're eventually going to -- that's
3 never going to happen, because nobody wants to go
4 through transfer agents.

5 So I don't even know why that's in the
6 report, because very few brokerage firms put stock in
7 a customer's name. Customers don't want to hold it.

8 If the brokerage firm is holding their
9 security, they always -- they never hold it in a
10 customer's name. They hold it in -- in the street
11 name. And the dividends don't -- do not go to the
12 customer directly from the -- from the company --

13 Q. Right.

14 A. -- transfers. They get paid to the broker,
15 and then the broker would make the customer whole.

16 Q. And that would have been true for the 1980s?

17 A. Yes.

18 Q. Okay. Now, in paragraph 115 Dubinsky wrote,
19 "Trade confirmations fabricated by the IA business to
20 support the convertible arbitrage trades were actually
21 prepared backwards, as though BLMIS was trading as a
22 principal, rather than an agent."

23 A. Oh, that's true. I mean, we always trade as
24 principal, as I said before. Doesn't mean they were
25 created backwards.

1 Q. Right.

2 A. I mean, it says right on the customer
3 confirmation that we're trading as principal.

4 Q. Right.

5 A. And that's not -- that has nothing to do
6 with whether you're trading it backwards or not.

7 Q. Right.

8 A. He's almost insinuating that -- from that
9 statement that trading as a principal, there was
10 something wrong with it. That would be great news to
11 the industry.

12 Q. I want to just interject some questions on
13 another subject. Can you describe for us what kinds
14 of trading you did with Bear Stearns?

15 A. Mostly market-making, proprietary trading or
16 for Bear Stearns' customers. There's -- our trades
17 with Bear Stearns were typical of what we traded with
18 everybody.

19 It was -- we were trading basically for Bear
20 Stearns' own account or for their customers' accounts.
21 If Bear Stearns got -- wanted to buy and sell stock
22 for -- for one of their clients, they had to go to a
23 market-maker, like myself, unless Bear Stearns traded
24 the stock himself. Then he would internalize the
25 stock himself, just as I'm doing.

1 Q. Okay. So Bear -- but Bear Stearns was a
2 market-maker; right?

3 A. Some -- in some of the securities. Yeah.

4 Q. Okay. And they were doing convertible bond
5 trades in the 1980s?

6 A. Yes.

7 Q. Okay. So why would they need you?

8 A. Well, because they may have not been making
9 a market in the convertible bond that we were making
10 the market in. In other words, they -- you know,
11 there are times when we were a market-maker in a
12 convertible bond, and we bought it from somebody else
13 as well.

14 If -- if we didn't -- if we didn't have the
15 stock in inventory, and we didn't want to short it to
16 a client, we might go to Bear Stearns, and they might
17 do the same thing to us.

18 But Bear Stearns was a competitor at times,
19 and they were not a competitor, you know, at times.
20 But Bear Stearns was -- was one of our big clients.

21 Q. Did they buy securities for you and hold --
22 and hold those securities?

23 A. Did Bear Stearns? We had accounts at Bear
24 Stearns. Yes.

25 Q. So there would have been times when you

1 purchased securities through them, and they would hold
2 those securities?

3 A. Bear Stearns?

4 Q. Yeah.

5 A. Probably not. You know, usually they would,
6 you know -- it depends upon what -- what kind of stock
7 it was and whether it was a stock that went through
8 the clearinghouse or not.

9 Q. Or convertible bonds, would they sometimes
10 be holding some of your inventory?

11 A. No. They wouldn't typically be holding
12 convertible bonds for us.

13 Q. Would you be holding convertible bonds for
14 them?

15 A. Probably not.

16 Q. Okay. I'd -- I'd like to look at pages 48
17 and 49 of the report.

18 A. Uh-huh.

19 Q. This is -- in paragraph 117, if you can just
20 read it to yourself, and then I'll ask you some
21 questions.

22 A. This -- this was an example that I pointed
23 to earlier where he fails to understand he's reading
24 the confirmations wrong. He's reversing -- he's
25 confusing the we -- we to -- to you.

1 Q. Okay. Okay. And he's -- he's concluding
2 that this is -- this is evidence of your fraud; right?

3 A. Yeah. He's -- right. I mean, it's --
4 clearly he's -- he's not understanding that when we
5 say, "We bought," it's we bought from the customer or
6 we sold to the customer.

7 Not as he's -- so he's saying that if we --
8 if we wrote the confirmation wrong, the trade never
9 could have taken place, because he's -- he's not
10 reading it properly.

11 Q. Right. Can you describe for us the kinds of
12 transactions you did for Carl Shapiro's various
13 accounts that you felt uncomfortable about doing?

14 MR. SHEEHAN: Object.

15 THE WITNESS: Okay. Well, I -- it
16 would be easier for me to explain the strategies
17 that I initiated for the big four accounts, which
18 Carl Shapiro would be included in that.

19 The -- we have to go back to -- this is
20 going to take a little bit of time. How much
21 time do we have?

22 MR. SHEEHAN: The rest of the
23 afternoon.

24 THE WITNESS: Oh, okay. That's fine
25 with me. Unfortunately, I have nowhere to go.

1 MS. CHAITMAN: Yeah. Do you -- are you
2 getting tired?

3 THE WITNESS: No. I'm -- I'm fine.

4 MS. CHAITMAN: Are you getting tired?

5 MR. SHEEHAN: No.

6 MS. CHAITMAN: Okay. Everybody is
7 okay?

8 MR. SHEEHAN: I haven't fallen asleep
9 once.

10 MS. CHAITMAN: You're okay?

11 THE WITNESS: I'm okay.

12 MS. CHAITMAN: You're okay? Everybody
13 is okay?

14 MR. SHEEHAN: Yeah. We --

15 MS. CHAITMAN: You're getting tired?

16 MR. SHEEHAN: We can go for a little
17 while longer. I'm okay.

18 THE WITNESS: Yeah, I have nowhere to
19 go. So --

20 MR. SHEEHAN: Sure. That's true, but
21 it's your call. It's your dep.

22 THE WITNESS: No. I'm all right.

23 MS. CHAITMAN: Is everybody else okay?

24 MR. SHEEHAN: Sure.

25 THE WITNESS: Okay.

1 MS. CHAITMAN: Why don't we -- why
2 don't we say we'll go to 2:30 and evaluate how
3 everybody is?

4 MR. SHEEHAN: That's fine.

5 MS. CHAITMAN: Okay. Good. Okay.

6 THE WITNESS: All right. This goes
7 back to the -- the Madoff misery. All right. In
8 1980 I was approached by some foreign clients,
9 basically French clients, institutional clients,
10 to -- for those of you that are old enough to
11 remember this -- that excludes you.

12 MS. CHAITMAN: Amanda, we're excluding
13 you.

14 THE WITNESS: That excludes you.

15 In 1980 Mitterrand came in to be -- to
16 be president of the premier of France, and
17 basically was a socialist, but, you know, also
18 being accused of being communist, and decided to
19 nationalize the banks and the industries in
20 France.

21 So there was a hysteria in France,
22 because everybody thought that France was going
23 to go down the tubes. At -- and what -- he put
24 into place currency controls, so that French
25 citizens were not allowed to own any currencies,

1 other than the franc.

2 So if you were a French citizen, you
3 couldn't own dollars or yen or anything else.
4 You had to own just French francs. You couldn't
5 trade in any currency.

6 And the French franc was going to be
7 devalued dramatically. So there was hysteria in
8 France to get their assets out of the franc and
9 into dollars.

10 But the only way that you could do that
11 is you could own U.S. assets, like securities.
12 And in order to do that you would sell the franc
13 and buy dollars to purchase the U.S. security,
14 because U.S. securities had to be settled and
15 paid for in dollars.

16 So the -- there was an interest in
17 people taking -- selling the French franc,
18 converting the francs into dollars, and then
19 being able to buy U.S. securities, which traded
20 in dollars, and they had to be held in -- in
21 dollars. And that way your -- your -- you now
22 had your currency -- your assets held in
23 dollar-denominated securities.

24 The -- that was the one loophole that
25 the government allowed French citizens to do, was

1 to buy U.S. stocks, and to do that you sold the
2 franc on the dollar.

3 So the -- anybody that was -- that
4 wanted to do that had to find a broker that would
5 buy U.S. securities for them. So I was
6 approached by some large, you know, French
7 citizens that were very wealthy that wanted to do
8 this, that wanted to establish a portfolio of
9 U.S. securities, so that they could get their
10 money out of the French francs and into the
11 dollars.

12 It was a perfectly legal strategy. It
13 was not anything unique or new, but to do this
14 you, obviously, you know, accomplished what you
15 wanted to do, but you now had your money in
16 dollars, and you ran the risk of the U.S. market,
17 because you owned -- you -- you had your money in
18 U.S. securities.

19 So because at that time our reputation
20 was as an arbitrage firm, that was -- had some
21 sort of expertise in hedging, I was approached by
22 these French citizens and some Swiss banks to
23 execute this transaction for them.

24 I did -- did this type of trade, and so
25 did Goldman Sachs and some other arbitrageurs in

1 Wall Street. Basically it was -- they were all
2 the --

3 During that time the arbitrage business
4 and convertible bonds or any type of what's known
5 as bona fide arbitrage was controlled by the --
6 the Jewish arbitrageurs. That was like Goldman
7 Sachs, Bear Stearns, you know, the Gruss &
8 Company. There was a whole -- there was a list
9 of -- of firms.

10 And I had already been established as a
11 trader in convertible bonds. I was sort of
12 minted by Gus Levy, who is a senior partner of
13 Goldman Sachs, and Cy Lewis from Bear Stearns and
14 so on and so forth.

15 So what happened was I was approached
16 by these Frenchmen to -- to do this trade for
17 them. However, what they wanted to do was also
18 hedge this portfolio of U.S. stocks that they
19 had.

20 BY MS. CHAITMAN:

21 Q. Can you give us the names of the people
22 you're talking about in France?

23 A. A family known as the Igoins, Albert Igoin,
24 I-g-o-i-n. Jacque, you know, Amseleum was another
25 one. And then there were some other Swiss bankers --

1 Swiss bankers and French, you know, entities.

2 Eventually I owned -- I did these trades for
3 people like Christian Dior, the Bettencourts, who
4 owned L'Oreal, and so on and so forth.

5 So they came to me, and they said, okay.
6 Can you put this portfolio of securities together?
7 And I said, yes, I can put the portfolio of securities
8 to buy for you, but you're going to be involved with
9 the market risk.

10 So they said, well, how can you hedge that?
11 So I said, well, you can -- you can go short against
12 the box. It's a strategy where you would short the
13 stock. Or you can short similar securities. There's
14 any number of forms -- ways you can hedge it. Using
15 options and so on and so forth.

16 So they said, okay. That -- that's fine.
17 Go ahead and do that for us. So I started doing that
18 business for them.

19 It so happens at that same time I was
20 trading -- doing convertible bond arbitrage for, you
21 know, these four families, the Shapiros, Picowers,
22 Levys and the Chaisses, where I was doing basically
23 general convertible bond arbitrage for them, which
24 were involved doing -- going long in convertible bonds
25 and short the common stock.

1 However, the -- the tax rate at that time in
2 the '80s was a very high rate, anyways, at that time.
3 Like an 80 percent tax rate on short-term capital
4 gains.

5 So I had one group of clients that were
6 doing -- that was doing convertible bond arbitrage,
7 but they were all short-term gains, taxed at the
8 short-term rate.

9 And then I had these French people that were
10 doing, you know, this currency arbitrage. The U.S.
11 clients, these four big clients, were -- in order to
12 save money on taxes was using silver straddles to
13 convert short-term gains into long-term gains, which
14 is a common strategy that most sophisticated investors
15 were using at that time.

16 They were using silver straddles. They were
17 doing that through Bear Stearns, through E.F. Hutton,
18 through Merrill Lynch. Those were the firms -- I did
19 not trade in commodities.

20 So they were doing this -- this trading
21 through these other firms, which was, you know, using
22 these straddles to convert the short-term gains that
23 they had in the -- in the stock market trades with me
24 into long-term gains with them.

25 But the IRS, the Internal Revenue Service,

1 was questioning the use of silver straddles for
2 everybody, you know, in the United States. They were
3 saying that there was no risk involved in these
4 trades, and they thought that these trades were --
5 boarded on being sham transactions.

6 So they were disallowing the use of silver
7 straddles to -- to offset, you know, short-term gains
8 and convert them into long-term gains. So my -- I had
9 these -- these four families that were using these
10 silver straddles, as I said, through Bear Stearns,
11 E.F. Hutton and Merrill Lynch.

12 And they wanted to not use these -- those --
13 that method. And Picower was using leasing shelters.
14 He had a leasing company to offset these gains. So
15 they came to me. They were -- they had been clients
16 of mine starting in the '60s and so on.

17 And I was generating convertible bond
18 arbitrage trading profits for them for years, where
19 they were making anywhere from 20 percent, 18 percent
20 to 15 percent.

21 So everybody was very happy and making a lot
22 of money with me, and I was happy doing it, but they
23 now were in a situation where the tax rates were very
24 high. And they came to me and said, look, we can't
25 use the silver straddles to convert your short-term

1 gains into long-term gains.

2 You know, what can you do to -- to help us
3 on this thing? I said, well, there's basically
4 nothing I can do, because the tax shelters that you're
5 using I don't recommend. I'm not in the tax shelter
6 business. I'm certainly not -- you can't -- I'm not
7 in the commodities business.

8 I said, you can't use the commodity trades
9 anymore. The only thing that I know that you can do
10 is to generate long-term gains, rather than short-term
11 gains, but the arbitrage profits that we've been doing
12 for years are all automatically long -- short-term
13 gains.

14 So you've got to stop -- you've got to stop
15 doing that sort of trading. If -- if you don't want
16 to pay the taxes at the short-term rate, I said,
17 you've got to use another strategy.

18 So what other -- what other strategy can we
19 use? I said, well, you can -- you can use a -- a
20 portfolio of stocks. You know, hold them for one
21 year. And if the market goes up for one year, you'll
22 have long-term gains and pay the long-term gain rate.

23 They said, well, that's terrific. I said,
24 yeah, except that you're now subject to market risk,
25 you know. So I said, the market has to go up. I

1 can't guarantee you the market is going to go up over
2 the next year.

3 I said, it might. I said -- I happened to
4 be bullish at the time. This was also 1980. I said,
5 I can try and hedge it for you, but, again, there's no
6 guarantee, you know.

7 So they said, what kind of hedges can you
8 do? I said, you can go short against the box, which
9 really isn't a good strategy to use, because the IRS
10 will challenge that the same way they'll challenge the
11 silver straddles, but you can go short similar
12 securities.

13 Meaning you can buy IBM and then short
14 Hewlett-Packard or Dell computer, you know, things
15 like that. That's perfectly legal. Perfectly --
16 it'll stand up tax wise and so on.

17 But, again, this strategy will only work if
18 the market goes up, and you have to be willing to hold
19 the stock for one year. So they said, okay. Let's
20 try it.

21 So I said, all right. I said, as it turns
22 out, I have a great situation for you. I said, I have
23 a group of French clients that are hedging their
24 currency trades with -- I'm putting together a
25 portfolio of stocks for them with their long and

1 short.

2 I said, you want to do a similar type of
3 strategy, long and short. So now we can have a good
4 liquidity pool, you know. I can put both of your
5 trades together.

6 I said, that's the good news. The problem
7 is the French people, they want to -- they don't want
8 to unwind or undo their transactions, you know, right
9 away, I said.

10 So you're going to have to sort of
11 understand they're -- they want to hold it -- you want
12 to hold it for -- your period -- your stock for one
13 year. They don't -- they also want to hold it, but
14 we're going to have to sort of, you know, coordinate
15 this thing, where, you know, we're not going to
16 unwind -- meaning we're not going to sell your
17 portfolios before they want to sell their portfolios
18 and so on.

19 So there has to be some sort of coordination
20 with this. Now, this is a, you know, perfectly legal
21 situation to do, but, you know, you're making some
22 sort of a commitment that when you want to sell,
23 they're going to want to unwind their -- their
24 transaction together.

25 All right. Goldman Sachs was doing a

1 similar type of arrangement, but they were doing it
2 primarily for the firm's, you know, best clients and
3 their own partners. This was a, you know, obviously a
4 very sort of specialized type of transaction.

5 Q. Let me just interrupt you here. Were you
6 actually purchasing the securities for the French
7 clients?

8 A. Everybody was buying.

9 Q. Okay.

10 A. These were perfectly legitimate.

11 Q. Okay.

12 A. Everybody was buying and selling. The big
13 advantage, as I said, was that there was a two big
14 liquidity pools on both sides of the transaction.

15 In other words, there was -- here you had a
16 group of clients looking to accomplish pretty much the
17 same thing. Although, one -- they were both doing it
18 for tax purposes. Perfectly legal, but -- but
19 different, because of the way the currency -- the way
20 the tax laws were in the different countries.

21 So everybody said, fine. Go ahead. You
22 know, so we -- I -- we started doing this transaction,
23 and it worked out. It was like a dream. The market
24 from 1980 continued to march upward.

25 So the four big families had these

1 portfolios where the stocks went up. They had
2 long-term gains on -- you know, it looked like they
3 were getting long-term gains on their long portfolio,
4 and on the short portfolio that was hedging it, they
5 were having short-term losses.

6 All right. Which was fine, especially if
7 the long positions went up more than the short
8 positions went up. So you had a -- you know, one
9 could go up 30 percent, and one could go up 20
10 percent, but you were making the difference of ten
11 percent.

12 So it worked like a dream. Everybody was
13 happy, including myself. That goes fine from 1980
14 literally through 1987. And comes 1987, the market
15 crashes, and the -- the four families, particularly
16 really two families, Picower and Shapiro, more than
17 Levy and Chais.

18 Primarily it was the two of them, but let's
19 say three. Throw Chais in that pool. Decided,
20 listen, the market is crashing. The game is over.
21 Now all of these stocks that went up over the past,
22 you know, years --

23 And some of them, they literally held these
24 positions open for almost eight years. They -- let's
25 sell out, because the market is going to -- the market

1 is crashing, and I'm going to go -- continue to go --
2 continue to go lower. I'm going to lose all of our
3 long-term gain advantage. So I want to get out.

4 The problem was that this was not a good
5 time for the French people to close out their
6 transactions. So I said, look, let's not everybody
7 panic. The market is -- you know, is going down,
8 clearly, but it's going to recover. Let's not sell
9 out, I said.

10 And we have commitments. I can't, you know,
11 start liquidating you and -- and then it's going to
12 screw up my relationship with -- and your relationship
13 with the -- with the foreigners. So let's just hold
14 on.

15 That went fine, but -- you know, for about a
16 day, but then, you know, Shapiro and Picower,
17 everybody -- they got hysterical and said, no, no, no,
18 no. We want to sell out.

19 So I had no choice, because these
20 commitments that we had made to -- you know,
21 originally were all verbal commitments, and I couldn't
22 literally, you know, tell them, you can't sell, you
23 know. If they wanted to sell, they wanted to sell.

24 So we started liquidating their portfolios
25 on the long side. And they said, well, wait, you

1 know. I said, you've got to liquidate the short side
2 also, but -- you know, you can't liquidate one side
3 without the other.

4 So, to make a long story short, they -- they
5 convinced me to -- to -- you know, to leave the
6 shorts -- to take over their short positions for them.
7 And that way -- because they wanted me -- let's get
8 out of everything.

9 And I said, no, no, no, because you're going
10 to screw up my relationship with the foreigners. I
11 said, we can't do that. And that was my mistake. I
12 mean, I -- I had no recourse.

13 I mean, I could have -- could have tried to,
14 you know, sue them, but I had no legal grounds to sue
15 them. So I -- I wound up selling their long positions
16 for them, sending the money they needed to pay their
17 taxes and taking over the short.

18 They were convinced that the short positions
19 were -- were going to go down also. So that they --
20 they said, listen, you're -- you're worried about the
21 short positions going up. The market is going to
22 crash.

23 We're going to -- we'll make money on the
24 long side, selling them out, and the short -- we'll
25 wind up making money on the short side also. I said,

1 you know, that's not going to happen.

2 So for awhile they seemed -- they seemed
3 correct. The market, you know, continued to sell off,
4 and we -- you know, you know, they weren't that
5 worried about it.

6 But then, of course, the market turned
7 around, and they started losing money -- I started
8 losing money on the short positions, because I was --

9 Oh, by the way, at that time I made -- what
10 happened was in order for them to convince me to do
11 this for them, they said, okay. You take over the
12 short positions, and we'll hold you harmless from any
13 losses you take on it.

14 You know, they were so convinced that --
15 that they were right, that the market was never going
16 to recover, they were going to make money on the long
17 side and on the short side, you know, they said,
18 you're going to make money on the short side. Don't
19 worry about it.

20 Well, the market turned around. The -- they
21 did make their money. They made huge profits on the
22 long side. On the short side I wound up losing money.
23 It was a terribly stupid thing, you know, for me to
24 do. I mean, people that knew me said, how on earth
25 could you do such a thing, you know?

1 Q. Did you have a written agreement with the --

2 A. I had --

3 Q. -- four families --

4 A. I had --

5 Q. -- or --

6 A. Yes. As a matter of fact, Carl Shapiro's
7 attorney was a man -- was one of the senior partners
8 at Coopers & Lybrand, which then became Price
9 Waterhouse, who was also doing this type of trading
10 with me at the time.

11 And we put together hold harmless agreements
12 that said they would be responsible for any of my
13 losses that I -- that I took.

14 And, first, they wanted to do everything
15 verbal, said, don't worry, you know, we have these
16 relationships with you. You don't have to worry about
17 it.

18 And I said, look, you guys are -- Carl
19 Shapiro was -- they were older at this time. You
20 know, they were old guys. He was ready to die, he
21 claimed, at 60. Still going strong at 103, but --

22 I said, look, put it -- I said, you know --
23 I said -- he said, don't worry about it. My children
24 will make you whole. They'll respond. So every --
25 everybody -- their children, by the way, were my age.

1 So, you know -- and they were friends of mine. So
2 it -- this whole thing was like a whole family type of
3 situation.

4 But I said, look, you know what? I trust
5 everybody. Let's put it in the trust agreements. So
6 they -- I became the executor of their estates. They
7 sold -- they changed their trust agreements.

8 As a matter of fact, Norman Levy -- J.P.
9 Morgan was the executor of his estate. And I said, I
10 don't -- you know, I don't trust J.P. Morgan. You
11 make me the executor -- executor of the estate.

12 So I became the executor of the estate, and
13 they signed agreements with -- they also had -- some
14 of the trust agreements, they guaranteed J.P.
15 Morgan -- J.P. Morgan could only trade through me for
16 their account on some of the trust agreements.

17 But J.P. Morgan was smart enough to say,
18 okay, well, we want you to hold us harmless from any
19 liability. If Madoff makes dumb investment decisions,
20 we don't want to be responsible as the trustee.

21 So they -- all of this was done. It was
22 fine. Of course, by -- you know, after a period of
23 time, they probably changed all of their trust
24 agreements, you know, because -- but, in any event,
25 I --

1 Q. Let me just interrupt.

2 So you had -- you had agreements with Norman
3 Levy, Carl Shapiro?

4 A. Right.

5 Q. With Jeffry Picower?

6 A. Yes.

7 Q. And with Stanley Chais?

8 A. Right.

9 Q. Okay.

10 A. The -- of course -- you know, it really sort
11 of doesn't matter, because, you know, I never was --
12 I -- I really couldn't sue any of these people,
13 because for me to start --

14 One of my choices was, when I started taking
15 these losses, was to start suing everybody, but that
16 would have been a total disaster. I -- I couldn't
17 start suing people, because it would have -- you know,
18 I never would have gotten paid, you know, on these
19 things.

20 So, outside of the fact they were starting
21 to trade away from me at these firms, also going short
22 and losing money, and I -- I was concerned that I was
23 ever going to get paid, you know, because Jeffry
24 Picower was saying, well, you know, I don't have the
25 money anymore and so on and so forth.

1 The -- this -- I then made the decision I
2 had to -- I had to, you know, take on new business,
3 because I was depleting my capital from the losses
4 that I was incurring from -- on these transactions.

5 And I decided to, you know, start handling
6 hedge funds. I had -- also had put together this --
7 come up with at the same time this split-strike
8 strategy trade, which I thought was a -- you know, a
9 sensible trading strategy. It was.

10 And I had been, you know, asked by -- by the
11 immediate world to get into this strategy. The
12 split-strike strategy was a strategy that I sort of
13 developed, because the --

14 The -- the collar of the split-strike
15 strategy is not a new strategy, but what I decided to
16 do was build a collar strategy out of it. I don't
17 want to bore you with all of the details, but it
18 involved hedging.

19 And so, not only -- you would buy a
20 portfolio of stocks. You would sell calls against it
21 to take in a profit, but then you would hedge yourself
22 by buying puts on the side.

23 So it was a strategy that -- that, you know,
24 was very appealing to a lot of people. To do the
25 strategy you had to deal with a dealer, like myself.

1 Because I was trading in the over-the-counter market,
2 I had -- was now doing all of this business away from
3 the floor of the exchange. So everybody wanted to
4 come in to do business.

5 My concern was -- I said, okay. This is
6 fine. Now, everybody wants to come in. All of a
7 sudden I can develop this investment advisory
8 business.

9 The problem that I would have is the type of
10 people that this appealed to were the foreign hedge
11 funds, and that was known as hot money. In other
12 words, foreign hedge funds would do business with you,
13 but as soon as you had one bad quarter or one bad
14 month, they wanted their money back and they wanted to
15 disappear.

16 So I said, to do this investment strategy,
17 the split-strike strategy, you had to sort of stay the
18 course. You had to sort of agree to keep your money
19 in it, because as soon as -- if you have one bad
20 quarter, you know, it's not going to work.

21 So these hedge funds said, Bernie, we'll
22 have no money -- giving you money and keeping it with
23 you. You just have to make sure that you're not going
24 to return our money, you know, when you all of a
25 sudden decide you -- you -- you don't want to do this

1 anymore.

2 So I made a commitment. I said, fine.
3 You -- you become a client. You send me in the money.
4 I'll agree to not return it to you, you know. In
5 other words, their biggest concern was that I was
6 going to be approached by Goldman and Merrill Lynch
7 and everything else, because at that time those firms
8 wanted me to do it for them, this strategy.

9 They said, because -- you know, even though
10 they could do it themselves theoretically, they had
11 problems doing this type of business, because it was a
12 conflict of interest for them with their other
13 institutional business.

14 I know I'm boring you with all of these --
15 these details --

16 Q. Can I just interrupt you for just a second?

17 A. -- but it's a complicated situation.

18 Q. I just want to -- I just want to understand
19 something.

20 The '87 crash occurs. You then have to work
21 through with the big four an indemnification, because
22 you're going to assume their short positions?

23 A. Right.

24 Q. Are you saying that the losses that you
25 suffered as a result of taking over the short

1 positions for the big four is what ultimately forced
2 you --

3 A. Yes.

4 Q. -- into the split-strike --

5 A. That's correct.

6 Q. -- fraud?

7 A. Yeah.

8 Q. Okay.

9 A. Now, again, this is my own doing. In other
10 words, this was not -- you know, no one had a gun to
11 my head. My -- my choice was to not do this. Go
12 after these clients, you know, for the indemnity, but
13 the clients were claiming they didn't have the money
14 to pay me, because they were -- they were losing money
15 being short themselves away from me, you know.

16 So that was -- you know, believe me, I live
17 with this everyday, you know, for the past eight
18 years, you know, trying to figure out why I was so
19 stupid to do this.

20 And -- but you had to understand, unless you
21 knew me and you knew my relationship with these
22 people, these were like -- these guys were like
23 fathers, you know, to me or brothers to me that I had
24 made literally billionaires.

25 All right. And made myself a lot of money

1 also. And I was like, you know, the golden boy of
2 Wall Street, supposedly, this genius. And for me to
3 acknowledge that I was stupid enough to do this
4 situation with them would have been, you know, the end
5 of my business, the end of my relationship, you know.

6 I had a -- a firm of, you know, at that
7 time, you know, 200 people that I was responsible for
8 working. It would have been the end of Madoff. The
9 end of the firm, you know.

10 So I decided, you know, to risk this -- you
11 know, my whole life doing this split-strike
12 transaction. And the -- I took in the money and
13 started to try to do the transaction.

14 The market, you know, in '90 -- '92, as I
15 started to say, wasn't receptive to it. And I started
16 getting under pressure from the hedge funds to invest
17 the money.

18 They said, look, you know, you made this
19 commitment to take this money from us. You told us
20 you didn't want us to take it back. You know, we
21 don't want to -- we don't want to make treasury bill
22 interest.

23 I had put the money in treasuries, making
24 two percent. They were expecting to make ten or 12
25 percent in the strategy. And they kept on saying to

1 me, do something, you know.

2 And I said -- so, I said, you know -- you
3 know, I couldn't do the strategy. I said, well, you
4 know, I'll short the strategy to them. I'll -- I'll
5 put the trades on short.

6 Again, understand that as a market-maker I
7 frequently traded on the short side of the market.
8 That was my business. That's the risk. If you're a
9 market-maker, you're a risk-taker, and you long trade
10 sometimes. You short stock to customers. You short
11 stock in the street. That's the way you do your
12 business.

13 And, again, keep in mind that going short is
14 not a bad thing. It's not an illegal thing. It's
15 something that you -- that you do. And there's
16 nothing wrong with doing it, except when you do it the
17 way I did it, you know.

18 So to me to -- you know, to short the
19 strategy, I'm thinking, okay. I'll short the stock
20 for these -- these clients, and then that'll be a
21 short-term thing. It'll take me, you know, a week, a
22 month or whatever it is.

23 Eventually I'll work my way out of the --
24 you know, out of the trades, but, you know, it just
25 kept on building and building. And, you know, what I

1 thought would take a week or a month, you know, a day,
2 all of a sudden was now, you know, getting to be a
3 year.

4 The -- the biggest problem was I had taken
5 all of these monies in, and, although, I could have
6 done the strategy, it was -- I didn't have enough
7 volume to do these kinds of trades, because you're
8 talking now hundreds of millions and billions of
9 dollars of trades.

10 And the strategy itself, the split-strike
11 strategy, was a great strategy. It made a lot of
12 sense. And you have to understand, this strategy was
13 so good, you know, the concept -- and it was so -- it
14 was nothing ingenious, but --

15 It was a -- a sensible strategy, but in
16 order to do it, you had to be a dealer, a wholesaler,
17 like me. You had to be a market-maker, like I was. I
18 was sort of in a unique position to do that. And I
19 had a reputation of building this -- a tremendous
20 concept in -- in this business.

21 The strategy was so good, if you ever looked
22 at my client base of who I had as clients. It wasn't
23 just some stupid people. Henry Kaufman, who was the
24 chief economist of -- of Salomon Brothers, who moved
25 markets, was a client.

1 Almost every senior partner from Goldman
2 Sachs, Morgan Stanley, Bear Stearns, Merrill Lynch
3 were all clients of mine in the -- in the strategy.

4 So -- as a matter of fact, when the trustee
5 came down to meet with me that day, when you were
6 there, and they asked me who knew that this strategy,
7 you know, wasn't -- that you weren't doing the
8 strategy? Who knew this didn't make sense?

9 I said, look, do yourself a favor. Do not
10 go under the assumption that this was a -- such a
11 stupid strategy that, you know, everybody should have
12 known that you were committing a fraud, because that
13 was -- that was your concept.

14 What -- not you, David. Irving Picard's
15 concept was this -- this whole strategy didn't make
16 any sense. And why didn't it make any sense? Because
17 one of the world's great idiots, Harry Markopolos, the
18 whistleblower, he --

19 He was convinced that this strategy was so
20 stupid and so dumb and that Madoff never could have
21 done it. So he kept on going down to the SEC and
22 telling them, Madoff is committing a fraud and this
23 strategy makes no sense. I've been studying this
24 strategy. He can't possibly make these -- these
25 trades or make this credit.

1 Okay. Now, he was correct, in that, you
2 know, this -- you know, I couldn't have been doing
3 these trades, but the reason I couldn't do them is
4 because I couldn't possibly put that much money to
5 work at that time, because -- you know, he had no idea
6 how much money -- nobody had how much money I had
7 working through them.

8 All right. So when he went down to the SEC,
9 and he said, Madoff is -- is a fraud -- is a fraud,
10 the SEC kept on looking at all of the -- the strategy,
11 and they said, this strategy -- there's nothing wrong
12 with this strategy.

13 And they kept on asking everybody on Wall
14 Street, can Madoff do these trades? And they said, of
15 course, Madoff can do these. He's the one -- one of
16 the only ones that can do these trades.

17 He has all the -- all of his business, so on
18 and so -- so the SEC, you know, told him, you're --
19 you're nuts. It turns out -- he turned out to be
20 right, but for the wrong reasons. And everything
21 that -- that he told the SEC didn't make any sense.

22 All right. In any event, I said to the
23 trustee at the time, you're never going to -- you're
24 never going to win a case that says that these people
25 should have known this strategy was a fraud to begin

1 with, because too many smart people had the ability to
2 get the confirmations, look at the trades, analyze the
3 trades, would tell you that these trades could take
4 place. There was nothing wrong with the strategy.
5 And that was the case.

6 All right. To make a long story short,
7 the --

8 Q. It's too late for that.

9 A. Exactly. Exactly.

10 That was the disaster.

11 All right. So what was your -- the
12 finalizing of your question with regard to this? I
13 knew this was going to happen. It happens all of the
14 time.

15 MR. SHEEHAN: If you want to ask a
16 question, go right ahead.

17 MS. CHAITMAN: You know what? I
18 think -- I think that we've done enough for
19 today.

20 MR. SHEEHAN: Sure.

21 MS. CHAITMAN: I think we're all tired.

22 MR. SHEEHAN: Yeah, I think so. And I
23 think it -- I just want to put on the record
24 that, obviously, we're not finished with
25 Mr. Madoff, and I haven't had a chance to ask any

1 questions.

2 And you've given me a few thoughts here
3 today about some questions I'd like to ask you.
4 So I just want to preserve my right --

5 MS. CHAITMAN: No. Absolutely.

6 MR. SHEEHAN: -- to take time with
7 Mr. Madoff. And it may be the next day or the
8 day after that, whatever may be the case.

9 MS. CHAITMAN: Yeah. I mean, I -- I --

10 MR. SHEEHAN: We'll -- we'll be back.

11 MS. CHAITMAN: Yeah, and I haven't
12 finished. We really appreciate your patience and
13 giving us all of this information.

14 You and I will talk about how to deal
15 with --

16 MR. SHEEHAN: Yes.

17 MS. CHAITMAN: -- this?

18 MR. SHEEHAN: Yeah, yeah.

19 MS. CHAITMAN: Okay. And we can go off
20 the record.

21 THE VIDEOGRAPHER: This ends media
22 number three in the deposition of Bernard L.
23 Madoff. Going off the record. The time is
24 14:36.

25 (SIGNATURE RESERVED.)

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(DEPOSITION CONCLUDED AT 2:36 P.M.)

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C E R T I F I C A T E

I, BERNARD L. MADOFF, do hereby certify that I
have read and understand the foregoing transcript and
believe it to be a true, accurate and complete
transcript of my testimony, subject to the attached
list of changes, if any.

BERNARD L. MADOFF

This deposition was signed in my presence by
_____, on the _____ day
of _____, 2017.

Notary Public

My commission expires: _____

E R R A T A S H E E T

RE: SIPC VS. MADOFF

DEPOSITION OF: BERNARD L. MADOFF

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1 STATE OF NORTH CAROLINA

2 COUNTY OF PERSON

3
4 CERTIFICATE OF TRANSCRIPT

5
6 I, Lisa A. DeGroat, a Court Reporter and
7 Notary Public in and for the aforesaid county and
8 state, do hereby certify that the foregoing deposition
9 of BERNARD L. MADOFF, was taken by me and reduced to
10 typewriting under my direction; and the transcript is
11 a true record of the testimony given by the witness.

12 I further certify that I am neither attorney
13 or counsel for, nor related to or employed by any
14 attorney or counsel employed by the parties hereto or
15 financially interested in the action.

16 This the 3rd day of January, 2017.

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21
22 LISA A. DeGROAT

Registered Professional Reporter

23 Notary Public #19952760001

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[& - 2:30]

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[anybody - awake]

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Rule 30

(e) Review By the Witness; Changes.

(1) Review; Statement of Changes. On request by the deponent or a party before the deposition is completed, the deponent must be allowed 30 days after being notified by the officer that the transcript or recording is available in which:

(A) to review the transcript or recording; and

(B) if there are changes in form or substance, to sign a statement listing the changes and the reasons for making them.

(2) Changes Indicated in the Officer's Certificate. The officer must note in the certificate prescribed by Rule 30(f)(1) whether a review was requested and, if so, must attach any changes the deponent makes during the 30-day period.

DISCLAIMER: THE FOREGOING FEDERAL PROCEDURE RULES ARE PROVIDED FOR INFORMATIONAL PURPOSES ONLY.

THE ABOVE RULES ARE CURRENT AS OF SEPTEMBER 1, 2014. PLEASE REFER TO THE APPLICABLE FEDERAL RULES OF CIVIL PROCEDURE FOR UP-TO-DATE INFORMATION.

VERITEXT LEGAL SOLUTIONS
COMPANY CERTIFICATE AND DISCLOSURE STATEMENT

Veritext Legal Solutions represents that the foregoing transcript is a true, correct and complete transcript of the colloquies, questions and answers as submitted by the court reporter. Veritext Legal Solutions further represents that the attached exhibits, if any, are true, correct and complete documents as submitted by the court reporter and/or attorneys in relation to this deposition and that the documents were processed in accordance with our litigation support and production standards.

Veritext Legal Solutions is committed to maintaining the confidentiality of client and witness information, in accordance with the regulations promulgated under the Health Insurance Portability and Accountability Act (HIPAA), as amended with respect to protected health information and the Gramm-Leach-Bliley Act, as amended, with respect to Personally Identifiable Information (PII). Physical transcripts and exhibits are managed under strict facility and personnel access controls. Electronic files of documents are stored in encrypted form and are transmitted in an encrypted fashion to authenticated parties who are permitted to access the material. Our data is hosted in a Tier 4 SSAE 16 certified facility.

Veritext Legal Solutions complies with all federal and State regulations with respect to the provision of court reporting services, and maintains its neutrality and independence regardless of relationship or the financial outcome of any litigation. Veritext requires adherence to the foregoing professional and ethical standards from all of its subcontractors in their independent contractor agreements.

Inquiries about Veritext Legal Solutions' confidentiality and security policies and practices should be directed to Veritext's Client Services Associates indicated on the cover of this document or at www.veritext.com.